The Economist

Panic over manufacturing
PAGE 61

Iraq, Bush and the UN
PAGES 15 AND 43

Japan's new reform chance
PAGES 14 AND 23-25

Profits from obesity
PAGE 64

September 27th-October 3rd 2003

Canada's new spirit

PRINT EDITION

Full contents
Enlarge current cover
Past issues/regional covers
Subscribe

GLOBAL AGENDA

POLITICS THIS WEEK

BUSINESS THIS WEEK

OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds

ONLINE FEATURES
Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

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European Voice
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Print Edition — September 27th 2003

Canada's new spirit
Exciting times, but much unfinished business, in the north ...
More on this week's lead article

The world this week

Politics this week
Business this week

Leaders

Canada
Canada's new spirit

Japan
Koizumi's second chance

State pensions in Europe
Work longer, have more babies

British universities
Not by marks alone

Iraq and the United Nations
Still divided

Clothing sizes
The female feelgood factor

Letters

On productivity, Hungary, Cambodia, Israel, Monte Cassino, parks, bravery

Special Report

Fixing Japan
Kill or cure?

United States

Education reform
Progress and confusion

Italian fashion and Texan justice
Dressed to kill

The California recall
After the debate

AIDS and abortion policy
Pregnant pause

The Louisiana governor's race
The Cajun, the virgin and Spa Boy

Bounty hunters
Wanted, dead or alive

Lexington
Taming the octopus

The Americas

Canada's political transition
Paul Martin's tall agenda

Brazil, Argentina and the IMF
Hard or soft?

Asia

China
Rich man, poor man

East Asia's oil
Your pipe or mine?

Afghanistan
Where opium is half of GDP

India
Ayodhya's shadow

Australia and Papua New Guinea
Big brother?

Indonesia
Not the easiest way of making money

Middle East & Africa

America, Iraq and the UN
To rescue Iraq, it's time to move on

Previous print editions
Sep 20th 2003
Sep 13th 2003
Sep 6th 2003
Aug 30th 2003
Aug 23rd 2003
More print editions and covers »

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Business

Manufacturing and politics
The misery of manufacturing

State aid in Europe
Rescuing Alstom

Television in India
Star turns

Online chat rooms
Shut up

Motorola
The ties that no longer bind

Video games
Sunny the vampire-slayer

The obesity industry
Big business

The litigation business
Trial Lawyers Inc

Face value
Germany's fat cats on trial

Special Report

State pensions in Europe
The crumbling pillars of old age

Finance & Economics

Currencies
A-a-and down!

Oil prices
Another pre-emptive strike

Investment banks
Fleet of foot

The New York Stock Exchange
Thin Reed

Retail banking in Japan
At your service

A Hungarian scandal
Attila the stockbroker

Economics focus
Into the valley of debt

Science & Technology

Flood barriers
Saving Venice

Malaria and the Gates Foundation
Clearing the air

Head size and mental ability
On getting a head

Books & Arts

Soviet cultural history
Dancing in the dark

American foreign policy
About turn

Literary memoirs
Things that might have been

Film autobiography
Marathon man

New fiction
Oh lucky man

Iraq's economic liberalisation
Let's all go to the yard sale

Iraq's constitutional troubles
Cursed by crime and numbers

AIDS in Africa
Slowly, the virus is being fought

Islamic law in Nigeria
Shilly-shallying with sharia

Mauritius changes government
Offshore and upbeat

Europe

The European Union and NATO
A lull between the storms

Germany's foreign policy
Playing all sides

Russian-American relations
Warm and fuzzy

Bosnia
Almost like one country

Turkey's poor
Suffer the little children

Charlemagne
Europe should vote

Britain

Public services
Can things only get worse?

Hutton Inquiry
Campbell's diary

Northern Ireland
Please police me

David Blaine
Empty box

Genetically modified foods
Sour taste

Council tax
Can't pay, won't pay

ID cards
Who am I?

Bagehot
Charles Kennedy's new strategy

Articles flagged with this icon are printed only in the British edition of *The Economist*

History in the theatre
All our yesterdays

New film
Tokyo rose

Obituary

Gareth Williams

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Child abuse

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Foreign-exchange reserves

Emerging-Market Indicators

Overview

Consumer prices

Economy

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Politics this week

Sep 25th 2003
From The Economist print edition

Hardly united

EPA

President George Bush defended the Iraq war at the **United Nations** and urged member states to help America rebuild the country; France's Jacques Chirac criticised the war and called on the Americans to transfer authority speedily to the Iraqis; Germany's Gerhard Schröder said differences over the war "have been left behind". A forthcoming report by the teams searching for Iraq's weapons of mass destruction was said to have found evidence of "programmes", but no actual arms.

See article: A tough sell

Iraq's Governing Council, appointed and guided by the Americans, announced that **Iraq's** economy is to be privatised and opened up to foreign investment, with the exception of its oil industry, which remains a state monopoly.

See article: Iraq's economic liberalisation

In a second attack on the UN's headquarters in **Baghdad**, a car bomb exploded, killing the driver and an Iraqi policeman. A member of the Governing Council, Aqila al-Hashimi, was attacked outside her home and later died. The Iraqi Governing Council decided to limit the operations of two leading Arabic news channels, al-Jazeera and al-Arabiya, at least temporarily, for "encouraging terrorism".

See article: Iraq's constitutional and religious troubles

Twenty-seven **Israeli pilots**, mostly reservists, said they would refuse to participate in "illegal and immoral" raids in the occupied West Bank and Gaza.

A special session of the UN General Assembly on **HIV/AIDS** heard that 41m people are now infected, 30m of them Africans. At another AIDS conference in Kenya, it was reported that nearly 60% of the infected Africans are women.

See article: AIDS in Africa

The police in **Zimbabwe** cracked down harder on the *Daily News*, a banned independent newspaper, saying they would arrest the owner and about 60 journalists for operating without a licence, shortly after a government media commission refused to grant one.

A *sharia* appeals court in Nigeria acquitted **Amina Lawal**, a woman convicted of adultery by a lower court last year and sentenced to death by stoning.

See article: Islamic law in Nigeria

Rebels in **Côte d'Ivoire** suspended their participation in the power-sharing government. Both sides accused the other of scuttling the peace effort. The road linking north to south was closed. Cocoa prices soared.

The case for defence

The leaders of **Britain**, **Germany** and **France**, meeting in Berlin, agreed to move ahead towards defence co-operation under the European Union's aegis, but it was unclear how much ground, if any, Britain had given to Germany and France, which have been keener in the past to integrate EU defence.

See article: Europe and NATO

In a speech at the UN in New York, after meeting George Bush, Mr Schröder indirectly asked for a permanent seat for **Germany** on the UN's Security Council.

See article: Germany's emerging foreign policy

The Christian Social Union, the **Bavarian** sister-party of Germany's Christian Democrats, crushed the Social Democrats in a state election on September 19th, by a margin of three to one. The result may strengthen the resolve of Edmund Stoiber, Bavaria's incumbent CSU premier, who failed narrowly to become Germany's chancellor last year, to seek Germany's top job next time round.

The **Dutch** foreign minister, Jaap de Hoop Scheffer, has been appointed NATO's secretary-general, replacing Britain's Lord Robertson, who is due to step down at the end of the year.

Latvians voted in a referendum, by 67% to 32%, to join the EU next year.

At a memorial service near Srebrenica in honour of the 7,000-plus **Bosnian Muslims** murdered there by Bosnian Serbs in 1995, the Bosnian Serbs' prime minister asked for “respect for the dead” and called for reconciliation.

See article: Conciliation in Bosnia?

Up to the job?

President George Bush's **job-approval rating** fell to 49%, the lowest of his presidency so far, according to the latest poll. It also showed that Wesley Clark, the latest Democratic candidate to enter the race for the presidency, trails Mr Bush by just seven percentage points.

An appeals court ruled that **California's** recall election should go ahead in October, reversing its earlier decision to postpone the ballot. The candidates held a third televised debate, with Arnold Schwarzenegger taking part this time.

Reuters

See article: Total reversal

An American air force translator working at **Guantanamo Bay** was charged with espionage. A Muslim army chaplain was also arrested on suspicion of spying.

In the wake of **Hurricane Isabel**, utility companies struggled to return electricity to more than 1m people along America's eastern seaboard. The storm will cost insurers some $1 billion.

No change

Japan's prime minister, Junichiro Koizumi, was re-elected as leader of the Liberal Democratic Party. In a cabinet reshuffle, Mr Koizumi retained his key economics minister, Heizo Takenaka, in both his posts, despite pressure from anti-reformists.

See article: Still in charge; now what?

South Korea's government proposed the largest increase in defence spending in seven years. This comes on the heels of North Korea's refusal to dismantle its nuclear programme, as called for in a resolution from the UN's nuclear agency.

South Korea's ruling Millennium Democratic Party split. A new grouping, called the “People's Participatory Party”, was launched by 37 members of parliament who fled from the MDP. The new party is the third-largest political group in parliament.

The prime ministers of **China**, **Russia** and four **Central Asian** countries signed agreements to establish a regional anti-terrorism centre in Uzbekistan. They also agreed to give the Shanghai Co-operation Organisation a central role in increasing economic ties among its members.

Next in line

Paul Martin, a former finance minister, took another big step towards becoming **Canada's** next prime minister, replacing Jean Chrétien, who plans to step down in February. In an election for delegates to the ruling Liberal Party's leadership convention, some 90% of those chosen back Mr Martin.

See article: Canada's political transition

Argentina offered short shrift to its creditors. It proposed to write down by 75% the value of $94 billion of bonds on which it defaulted in 2001. The bondholders wailed.

See article: Brazil, Argentina and the IMF

A young Briton escaped from kidnappers in a mountainous jungle region in northern **Colombia**. The kidnappers, thought to be from the ELN guerillas, continue to hold seven other foreigners.

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Business this week

Sep 25th 2003
From The Economist print edition

Oil change

OPEC took surprise action to prop up the price of oil. It announced a cut in production quotas of 900,000 barrels a day and seemed ready to make more cuts. Oil prices quickly rose. A representative from Iraq attended the meeting for the first time since the American-led invasion of that country.

See article: OPEC's surprise

Cut the chat

Microsoft announced that it would close down its internet chatrooms to prevent paedophiles from using the service to snare victims, though subscription-based services will remain in some countries. Rivals claimed that Microsoft was not prepared to pay for monitoring. With luck, the initiative will prove more successful than the computer giant's actions to counter viruses and spammers.

See article: About morals or money?

Gray Davis, California's besieged governor, signed America's most-sweeping **anti-spam law**, which prohibits the sending of all unrequested commercial e-mails. The law is expected to face stern court challenges as an unwarranted restraint of free speech and interstate commerce.

Americans hoping to escape the scourge of **telemarketing** suffered a set-back. An American judge ruled that the Federal Trade Commission had exceeded its authority in creating the National Do Not Call Registry, which would allow the imposition of large fines on telemarketers calling any of 50m listed residential phone numbers.

EMI began talks with **AOL Time Warner** over a $1.6 billion bid for the American media giant's music arm. The British firm had a similar offer rebuffed by Europe's competition watchdogs in 2000. AOL Time Warner had just broken off exclusive negotiations with Germany's Bertelsmann Music Group. BMG was reportedly investigating an alternative tie-up with Sony Music.

Christopher Galvin resigned from the family business. **Motorola**, a mobile-phone maker founded by his grandfather and also run by his father, suffered during the technology slump. Mr Galvin's strategy for beating the downturn was heavily criticised. Investors were overjoyed at his departure; the company's shares rose briskly.

See article: Motorola's mess

Vivendi Universal reported a loss of €632m ($697m) in the first half, something of a recovery from losses of over €12 billion the year before after a huge write-down of the value of its assets. Vivendi's telecoms and pay-TV arms made handy profits.

Minimum wage

John Reed, a former top banker at Citigroup, was named as the interim head of the New York Stock Exchange after Richard Grasso was forced to resign as a result of the furore over his $140m pay package. Similar controversy is unlikely; during Mr Reed's temporary tenure he will be paid just $1.

See article: An odd choice at the NYSE

America's big **investment banks** enjoyed a cheery third quarter. Goldman Sachs said that profits were 30% up on a year ago at $677m, Morgan Stanley's profits more than doubled to $1.3 billion and Lehman Brothers made $480m compared with $194m a year ago.

See article: Beating the bond-market rout

Josef Ackermann, chief executive of Deutsche Bank, is to stand trial for his role in approving large bonuses for managers at Mannesmann three years ago, while the German telecoms group was in the throes of a takeover by Vodafone, a British mobile-phone giant. Mr Ackermann was on the board of the German telecoms group.

See article: Germany's fat cats on trial

Financial engineering

The French government and the European Commission hammered out a revised rescue plan for **Alstom**, an ailing French engineering giant. The commission had rejected a previous bail-out attempt that included the government taking a direct stake. Despite the €3.2 billion ($3.7 billion) lifeline, Alstom's shares tumbled; investors fear for its long-term prospects.

See article: State aid in Europe

Swiss, an airline created from the rump of bankrupt Swissair in 2002, threw in its lot with British Airways and the oneworld alliance despite talk of a merger with Germany's Lufthansa.

Pfizer stiffened its resolve to stop two European drug firms, **GlaxoSmithKline** and **Bayer**, from selling Levitra, a rival impotence cure to Viagra. The American drug company claims that a previous case gave it a broad patent on Viagra. GSK and Bayer have since launched their product amid a blaze of raunchy advertising.

Strong for long?

The **dollar** fell to a three-year low against the yen and recent gains against the euro were reversed after the G7 group of rich countries called for “more flexibility” in exchange rates. John Snow, America's treasury secretary, first called the G7 statement “a milestone change” but later sowed confusion by saying that America's “strong dollar policy” still stood.

See article: Currencies

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Canada

Canada's new spirit

Sep 25th 2003
From The Economist print edition

Exciting times, but much unfinished business, in the north

IN 1995, the *Wall Street Journal*, pondering Canada's economic slump, bottomless fiscal deficit and towering public debt, judged that America's northern neighbour had become “an honorary member of the Third World”. Four years earlier, *The Economist* had fretted that Canada was “on the brink of bust-up”. We quoted a Canadian who compared his country's federation to a “boring party where the guests are too polite to leave. However, when the first guest makes a move to go, the others each claim other engagements and make a quick exit.” Still a fair description? Today's Canada is neither boring nor so exciting that it is on the brink of disintegration. Indeed, a cautious case can be made that Canada is now rather cool.

Part of what makes it cool is a certain boldness in social matters. Canada's government has recently announced its support for pioneering bills to legalise gay marriage and decriminalise marijuana, both excellent liberal ideas. It has granted home rule and control over mineral rights to some of its indigenous Indians. While other rich countries suffer a racist backlash over immigration, Canadians welcome migrants and are proud of their tolerance and cultural diversity. This has turned Canada's big cities into vibrant, cosmopolitan places. Canadian writers and other cultural figures enjoy unprecedented international success.

This social liberalism points to an increasingly self-confident country. Canada has at last tackled—or at least learnt to manage—the problems that beset it a decade ago when Jean Chrétien took office as prime minister. In 1995, a referendum on independence in Quebec was lost by only a few thousand votes. This year, the separatists lost power in the province after an election in which independence was barely an issue. Mr Chrétien can claim some credit: he has been a robust federalist, ramming through the Clarity Act, which places legal obstacles in the path of separation. And Quebec, in turn, has benefited from Canada's economic turnaround.

Deficits have been left far behind and the public debt slashed. Since the late 1990s, Canada's economy has outperformed the rest of the rich world. It no longer depends only on lumber, mining, oil and cars. Like any economy, Canada's is vulnerable to shocks, such as the recent outbreak in Toronto of the SARS respiratory disease and a case of mad-cow disease which has curtailed beef exports. But Canada has begun to close the gap between its living standards and those in the United States. Though this gap, at 15%, is far from trivial, many Canadians believe that their public health care, better protection of the environment and lower crime rate make them better off than their southern neighbours. Throw in its social liberalism, and Canada's “third way” looks to some like an attractive alternative to an increasingly conservative America. Certainly, Canadians themselves seem content. This week, Paul Martin took

another big step on his irresistible journey to the prime minister's office (see article). Though he and Mr Chrétien are personal rivals, they are the Liberal Party's co-architects of Canada's economic renaissance. Pundits expect Mr Martin to call a general election next year—and for the Liberals to win a fourth consecutive term.

The contrast across the 49th parallel between Canada and the United States makes for healthy competition in social and economic policy. But as with many a good-news story, Canada's loses a bit of its lustre under closer inspection. People continue to vote with their feet: a few thousand Americans move north each year, but are still outnumbered by Canadians moving south—and not, probably, just for the sun. Though the poor fare better in Canada, the middle classes earn less and pay higher taxes. The Liberal Party's domination of Canadian politics is far from being an unalloyed good. Without an effective opposition, much of the job of holding the government in check falls to the judiciary, policing a Charter of Rights which on one view, unlike America's Bill of Rights, tilts too far towards the rights of groups rather than individuals.

Unfinished masterpiece

On top of this, there are some big things that Canada continues to get wrong, and other big things that could go wrong without preventive action. In general, Canada still taxes too much, invests too little, and enjoys a free ride in defence from the United States. Since the terrorist attacks of September 2001, security and defence are a special worry. Much of Canada's economic success is built on a 1988 free-trade agreement that has seen a massive expansion in cross-border trade: the United States now takes 88% of Canada's exports. Just-in-time production means that components can cross the border three times in the making of a car, for example. If security threats turn the border into a barrier, firms will think twice before putting a factory in Ontario rather than Ohio. That does not stop Canada from holding different views about the world from those of George Bush, but it needs to work harder than Mr Chrétien has done at keeping the trust of the United States.

Conversely, firms also need positive reasons to invest in a market that is only a tenth the size of America's. This implies that Canada should continue with the tax cuts that Mr Martin launched as finance minister. At some point, however, this will damage the welfare state on which Canadians set such store. So far, the federal government has been able to balance its books mainly by passing this problem on to the provinces, whose finances are poised to unravel. The cities, too, have demands: today, the most visible cleavage in Canada is not between French-speaking Quebec and the English-speaking rest, but between five large urban areas (dynamic, successful, with many immigrants but with strained public services) and the rest (mainly rural, declining economies with high unemployment, kept alive by federal aid).

To keep its new cool, Canada must therefore overhaul the way its government allocates power and money. Quebec's new Liberal government could lead the way: it wants the private sector to help to deliver public services, as well as some further devolution. The rest of the country should follow. Canada has turned a corner. But it is not yet time to abandon its new spirit of risk-taking and experimentation.

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Japan

Koizumi's second chance

Sep 25th 2003
From The Economist print edition

Japan's prime minister has seen off a party challenge. Now he must drive his advantage home

Reuters

Get article background

FANS of Junichiro Koizumi can sign up to an e-mail service called Lionheart, which provides regular updates from their hero. His shaggy mane of hair apart, though, the name has not proved particularly appropriate since Mr Koizumi took over as prime minister of Japan in April 2001. Though he came into office promising “reform with no sacred cows”, his record has been modest. Now, however, that could be about to change. On September 20th, Mr Koizumi won a resounding victory to see off a leadership challenge in his own party. With Japan's economy showing signs of at least a cyclical revival, he looks well placed to call an early general election, probably in November, and to win his first real mandate for reform. Just as Britain's Margaret Thatcher achieved little early on in her premiership but made her main reforms a few years later, could the same come true for Mr Koizumi?

It certainly needs to. Japan's economic recovery, though welcome and probably assisted by a more expansionary monetary policy instituted by the man Mr Koizumi appointed in March to head the Bank of Japan, Toshihiko Fukui, risks petering out just as previous recoveries have done, especially if this week's rise in the yen proves long-lasting (see article). The country's terrifying stock of bad corporate debt, far from decreasing, has increased further, though at a rate which the government claims is “stabilising”. Those gigantic barrels of pork, Japan's highway corporations—deployed in the worst aspects of Japan's attempt to spend its way out of recession—remain steadfastly unprivatised. For Mr Koizumi, Japan's postal-savings system, a huge and superlative way of funnelling trillions of people's yen into all the wrong kinds of things, has for many years been a symbol of what needs to be changed in Japan. But moves to privatise that, too, have made little headway. The building industry, agriculture, the utilities: all are as sorely in need of a supply-side revolution as ever.

This is not all Mr Koizumi's fault. Since he took over, Mr Koizumi's main enemy has not been the official opposition but his own party, which has systematically hampered his attempts at reform, rightly fearing that these would be bad news for the groups—the farmers, the building industry and so on—that support and fund it. Mr Koizumi's own faction of the ruling Liberal Democratic Party (LDP) is a modest one, far smaller than the dominant (and archly conservative) Hashimoto faction, which has battled him from the beginning and has mounted (and failed in) what in any other country would be viewed as a back-stabbing attempt to bring down a popular prime minister. Mr Koizumi knew what he faced from the outset. His most acute slogan is “change the LDP, change Japan”, and the order is important: it recognises that until the party is fixed, the country cannot be.

Mr Koizumi's achievement in hanging on to his job is therefore considerable. Previous reformers, such as the ill-fated Morihiro Hosokawa, have been done in by their own side far more swiftly. He needed to win big in order to avoid a second-round run-off which could have seen his challengers united around one candidate—and he did. The manner in which he did it was striking, too: he made deals with influential players in the factions that were opposing him, fragmenting their vote.

For the moment, his opponents are humiliated, and should stay that way until after the general election. He says that the party's manifesto for that poll will be the platform on which he has just fought, and won, the LDP leadership battle. This is revolutionary for Japan, where the platform would normally be decided by the party machinery: that is, by the people who have been trying to unseat their own leader. Mr Koizumi has so far only had a limited test of his vote-winning skills, fighting an election for half of Japan's upper house, in July 2001. But already Japan looks a bit more like a normal country. The next election will now be fought by a well-known politician, with clear-cut policies backed up by a cabinet of his own choosing, not an amorphous jelly.

The new new team

For the cabinet marks the second of Mr Koizumi's successes. Two days after his re-election, Mr Koizumi shuffled his cabinet, and in doing so offered none of the concessions to the old guard that had been feared. Most notably, he retained Heizo Takenaka, an unpopular economist who is seen as the symbol of Mr Koizumi's reforms, in the twin roles of bank reform and overall economic policymaking. Mr Takenaka had been regarded as near-certain to lose at least the first of those jobs as the price for averting full-scale rebellion. There are other good things too: Mr Koizumi has promoted the energetic reformer Nobuteru Ishihara to the pork-critical Ministry of Land, Infrastructure and Transport. He has replaced Masajuro Shiokawa, the 81-year-old finance minister, with another ally, Sadakazu Tanigaki, a sprightly 58. The new party secretary-general is another young Turk, Shinzo Abe. His old cabinet was a compromise: the new line-up are Mr Koizumi's own men and women, not the LDP hierarchy's.

So all the pieces are in place for a significant change of gear. But will Mr Koizumi grasp the gearstick? Conspiracy theorists will continue to wonder what exactly was the price demanded for the support of Mikio Aoki, who broke ranks with the Hashimoto faction and brought many of its members with him. Without him, Mr Koizumi would probably have been forced into a run-off that he might very well have lost. Probably the most serious thing wrong with Japan—the long hangover caused by the crash of asset prices from 1990 onwards and, in consequence, of wealth and the propensity to consume—is something Mr Koizumi cannot tackle directly (see article). The solution, reflation on a heroic scale, lies with the independent Bank of Japan. But even so, there is plenty that Mr Koizumi could be doing. From bank clean-ups to agriculture, his inclination until now has been to compromise with his party and produce watered-down solutions. In a way, having demonstrated his mastery of the LDP's arcane machinery so successfully, Mr Koizumi is in a more difficult position than he was before. Then, he had a ready-made excuse. Now, he has to deliver.

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State pensions in Europe

Work longer, have more babies

Sep 25th 2003
From The Economist print edition

Europe's pensions crisis won't go away. Governments need to do more, and voters need to accept changes

Get article background

EUROPE is currently witnessing the slow-motion explosion of the most predictable economic and social time-bomb in its history. As life expectancy began to increase quickly in the second half of the 20th century and fertility began to decline in the 1970s, the foundations of Europe's generous state-pension systems began slowly to crumble. These are pay-as-you-go schemes that force today's workers to finance yesterday's workers' pensions, based on the assumption that workers hugely outnumber retirees. But this has not been true for at least two decades. The current worker-pensioner ratio in Europe has fallen to about three workers for each pensioner, and it looks set to fall to a mere three workers for every two pensioners within 30 years. Most European governments have responded to this looming crisis only with the kind of timid tinkering that does little more than shift the problem to their successors (see article).

This is precisely what the Italian government is about to do. Silvio Berlusconi's pension reform, unveiled this week, will come into effect only in 2008 when the current prime minister is unlikely still to be occupying the Palazzo Chigi in Rome. Instead of speeding up an earlier reform, Mr Berlusconi is merely fiddling with so-called “seniority” pensions that allow workers to retire at 57 if they have been in work for 35 years. Rather than abolishing these next year, as expected, he will continue them until 2008, and offer workers a fat bonus if they carry on working despite being eligible for what is now widely viewed as an over-generous perk.

Mr Berlusconi's loss of courage is typical of similar half-hearted efforts elsewhere. Germany is currently discussing an increase by monthly increments of the retirement age from 65 to 67 between 2011 and 2035, but even this minimal change is proving too much for the left wing of the ruling Social Democratic Party. France passed a law this year that will oblige its public-sector employees to work as long as those employed in the private sector in order to qualify for a full state pension, a welcome reform that should nevertheless have happened years ago. Austria's government dared to push through a rather more ambitious reform this year, but tiny Austria's spending on pensions is also of Italian proportions.

There is little mystery about why governments have been so pusillanimous. Changes to public pension schemes are extremely unpopular with workers and voters. In France and Italy, trade unions have often brought their countries to a standstill at the slightest hint of any change to pensions. Mr Berlusconi's attempts at pension reform played a big part in the downfall of his previous government in 1994.

And yet sooner rather than later, European governments, as well as the voters whom they are supposed to serve, will have to face the unpalatable truth that their current public pension schemes are not sustainable. Addressing that crisis will be painful for everyone, and no single remedy will be enough, but there are measures which both voters and governments should pursue—with some urgency.

First, governments will have to act much more boldly to reduce the scope of the core pay-as-you-go public pension system. Second, employees, public or private, should be encouraged instead to channel their savings into private retirement accounts, either administered by employers or (even better) run directly by fund-management firms, thus taking responsibility for their own retirements. If encouragement does not work, such private savings may have to be made compulsory. Third, the state retirement age should be scrapped, because a fixed pension age makes little sense either for privately-funded pension schemes, which should be encouraged, or for public schemes. Alternatively, or as well, many European countries will have to do something to address the effects of their declining birth rates in order to redress the imbalance between workers and pensioners.

Ten more years?

Revising current public-pension promises is tough. But the most immediately effective policy would be to raise the retirement ages in public schemes. Over the past few decades retirement ages in Europe have actually declined, even as life expectancy has soared. It is open to question whether workers with retirement now in their sights were really promised 30 years of leisure when they began their working life. If Europeans want to retain their public schemes—and most seem to want this—then it seems inevitable that they will have to work longer, probably at least five years, possibly as much as ten years longer. Employers, as well as workers, will have to adjust to this, but there are few good reasons why more healthy people in their 60s should not be holding down jobs, rather than sitting idle at younger taxpayers' expense.

Addressing the other half of the problem, the burden on younger workers in Europe, is just as necessary in the longer term, but an even more delicate task. Increasing immigration would be hugely controversial, but it makes good economic and social sense, and not only from the point of view of pensions, as this newspaper has often argued.

Even with more immigration, increasing the domestic supply of younger workers—ie, having more babies—could also be desirable and, if current trends continue, probably necessary. This sounds like the most pleasant of all remedies. But governments will have to tread warily here. Whether or not to have children is one of the most private of all decisions, and coercive social-engineering schemes should be repugnant to any liberal democracy. Nevertheless, the reason for plummeting birth rates in Europe may have something to do with the choice already forced on too many young women: start a career and put off childbearing until much later in life (which leads some to forgo it all together) or have children but miss out on the chance to compete in the workplace. Removing obstacles to women having children and pursuing a career simultaneously, through changes to the tax system and employment law, would not only help the next generation of young women and their children, but eventually their parents and grandparents as well.

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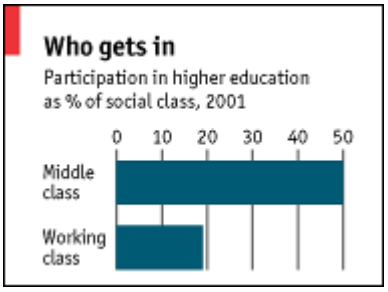
British universities

Not by marks alone

Sep 25th 2003
From The Economist print edition

Universities should discriminate in favour of poorer children with worse exam results



FEW things make rich parents more annoyed than the thought that their expensively-educated, hard-working children may lose out to lazy counterparts from feckless homes when it comes to higher education. Surely the best university places should go to those with the best results?

Against that background, this week's preliminary report from a government review of English university admissions (Scotland and Wales are different) has raised a rumpus. Currently dons face nominal targets for admitting disadvantaged students, with extra cash if they manage, and government disapproval if they don't. The new report suggests they should systematically award places to less-qualified, but more deserving, students. That infuriates some parents, but it is right.

Talent scouts

The well-crammed but incurious product of a successful school (a good state one just as much as a private one) may well be a less good bet than a determined candidate who has battled through a rowdy school with weak teaching. This is especially true in subjects such as advanced maths, classics or physics, which are well taught at private schools; many state schools teach them poorly if at all. Students from fee-paying schools gain slightly worse degrees than their A-level scores would predict—showing that private education does help pupils' chances of going to college. Universities are right to take account of that. This is not to advocate the affirmative action that American universities have been practising in favour of black people (upheld by the Supreme Court earlier this year and roundly condemned by this newspaper). Here, the aim is not social engineering but to uncover buried talent.

However, merely to discount the value of A-level grades acquired by pupils from good schools would be inadequate. Universities need more information about applicants. A-levels have been so devalued that top grades mean little these days: publishing percentage marks, rather than just grades, might help distinguish the brilliant from the merely well taught. Admissions tutors could gain useful extra information about their candidates from interviews, in-house entrance exams or even intelligence tests.

Identifying poor, clever children is only part of the problem. Their unwillingness to apply to top universities and their tendency to drop out are others. Some universities already make efforts to go out and get youngsters from poor backgrounds; more could. And all, once they have got them, need to try to keep them.

Should the government involve itself in these efforts by, for instance, subsidising them? Regrettably, yes. Although the government is moving towards a system which will give universities more freedom, at the moment it runs higher education. Until universities have more autonomy, and thus a real incentive to ensure that they get the cleverest children, the government should nudge them in that direction.

Yet none of this solves the fundamental problem: that most children of poor parents do badly at school. Only a quarter of children from working-class homes get the two A-levels typically needed for higher education; from middle-class homes the figure is 47%. For the good grades in hard subjects needed for the best universities, the results are even more skewed. Improving schools would do much more for social justice than fiddling with access to universities.

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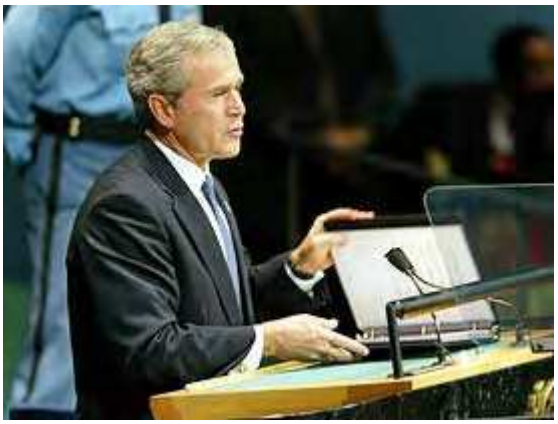
Iraq and the United Nations

Still divided

Sep 25th 2003
From The Economist print edition

As in fighting the war, America must rely mainly on itself to win the peace in Iraq

EPA



Get article background

THE Americans did not apologise, the French did not forgive. In fact, this week's speechifying at the UN General Assembly in New York left relations between the big powers in pretty much the same place they have been ever since the Americans and British went to war against Iraq's Saddam Hussein. France, Russia and Germany continue to say that doing so without the explicit approval of the Security Council ripped a hole in international law. America and Britain continue to say that laying down the law (by sending umpteen Security Council resolutions, threats and “final warnings” to Saddam) while refusing to enforce it would have been a queer way to uphold global order. Since France's president has invested mightily in standing up for a “multipolar” world against the American “unilateralists”, and America's is facing an election, neither side is going back down any time soon.

This continuing discord is no doubt a pity. But how much does it matter in practice? To listen to France's President Jacques Chirac, you might think that a serious principle was at stake: whether Iraqis are going to be given control of their own country or remain for ever under the supervision of the American-British coalition. You would be wrong.

France, says Mr Chirac, votes for the fastest-possible transfer of sovereignty from the American occupiers to the people of Iraq. But the Americans say they want just the same thing. Indeed, as the country with most boots on the ground, the Americans have a powerful interest in extracting themselves at the earliest opportunity from a potential quagmire in which their soldiers are being killed. The difference is that the Americans do not accept that the transfer of sovereignty can happen as fast as Mr Chirac claims to believe is possible. They know that the Iraqi Governing Council to which Mr Chirac expects them to hand power is not yet ready to wield it. Nor, as a creation of the occupying power, consisting largely of former exiles, does it yet command the respect of many Iraqis. So, for the present, the Americans are gritting their teeth and insisting on a more methodical route. First will come a new constitution, then a national election, and only later the transfer of power.

A second disagreement is whether, as Iraq prepares for independence, the occupation should be run by the coalition that fought the war or by a broader coalition under the closer direction of the UN. Here, too, Mr Bush might be thought to have a powerful self-interest in sharing out the work. As American voters gulp at the bill for securing and rebuilding Iraq, what looked at the time like a military triumph risks becoming a growing liability in the coming presidential election. Mr Bush would be the first to benefit if

the UN could take the Iraqi problem off his hands.

The trouble is, it can't. No matter what the Security Council says and does, American soldiers and taxpayers—such are the delights of superpowerdom—will continue to carry most of the burden in Iraq, and it is Mr Bush who will continue to carry the can if things go wrong. The Americans are eager to pass a new resolution that might persuade a handful of other countries to send a few thousand soldiers each, enabling the United States to rotate some of its own troops more frequently. A resolution that gave a bigger say in Iraq to the UN might also encourage some governments to be more generous at a forthcoming donors' conference in Madrid. But it now seems that a new resolution is far away, and, come what may, America will end up paying most. In these circumstances, how much control can Mr Bush risk surrendering in return for a marginal sharing of the burden?

A little. It is fine to have agreed to the possibility of a multilateral force under American leadership, or UN supervision of elections. But it would be a grave mistake for Mr Bush to give up America's overall control of events on the ground.

One reason for caution is the breakdown of big-power trust. Kofi Annan, the UN's secretary-general, says that whatever the different views about the war, all countries now have a vital interest in ensuring that the outcome is a stable and democratic Iraq. But does France, say, agree? In his haste to transfer power from the Americans to an Iraqi government that is patently unready to receive it, Mr Chirac hardly sounds ready to put the practical outcome in Iraq above a desire to refight the case against the war. The bitter truth is that having decided more or less alone to remove Iraq's dictator, America may now have to build Iraq's democracy more or less alone. Others can help on the margin, but Mr Bush's task now is to steel America to see through what America has begun, not vest false hopes in the prospect of rescue by others.

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Clothing sizes

The female feelgood factor

Sep 25th 2003
From The Economist print edition

Shocking news: a market that is rejecting standardisation

WE LIVE, it is said, in a world of standardisation: a place in which increasingly you can buy the same things—cappuccinos, food, cosmetics, fashions—in similar shops, in similar malls, in similar cities. The heart laments this and hopes it isn't really happening. The head, though, has to accept that it has advantages, for standardised products save time, reduce confusion, and may be cheaper and more predictable, especially when attached to a trusted brand. There is one market, however, in which hearts and heads alike are forcing things in a different direction: women's clothing. There, the customer is queen, and she seems to prefer confusion.

It is not the fashions themselves that are flouting standardisation. It is the sizes in which they are sold. Once upon a time these were predictable and numerological, even if the numbers used varied from country to country. It did not matter if a size 12 dress in Britain was called a 38 in Germany and a 44 in Italy, for a simple conversion chart would suffice. No longer. Increasingly, size is a matter of vanity not of measurement, for women have, well, become larger in various ways (see article). Not surprisingly, they would like to have their cake, eat it, and stay exactly the same dress size. Some clothing firms have accommodated such delusional desires by sticking to the same sizing numbers but making the clothes larger. Others have resorted to therapeutic words—petite, regular, “missy”. In America, it is even possible to buy women's clothes in size 0; presumably negative sizing cannot be far behind.

Men are, of course, going through the same dimensional change. They are not, however, encountering, or inviting, the same confusion. Occasionally it may be hard to work out what exactly is meant by “medium” or “extra large”, but mainly real measurements still rule. This may be because men have another option: for suit-wearers the best trick is to buy not the right new size but a size too big, for then the suit looks loose and people may be fooled into thinking you are getting slimmer, not fatter. Or perhaps their vanity is of a more primitive sort. A (possibly apocryphal) story about Winston Churchill has the great man recommending that among aid shipments sent during the second world war should be packages of British condoms, all large size but labelled “small”.

But for women, meanwhile, shopping is becoming harder: more things must be tried on, taking more time, and buying online is a poor option. Central planners, ignoring the fact that this is the result of expressed female preferences, would want standardisation reimposed. Here's an alternative suggestion for our freer era: clothing firms could agree a standard sizing to be put on some sort of bar code or tag. Then those who want speed and clarity could buy (or be given) an electronic reader to find out the easily comparable truth. Those who would rather fool themselves can continue to do so by reading the written labels. Such are the workings of invisible hands.

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Letters

Sep 25th 2003
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Highly productive

SIR – At least some of the apparent increase in American productivity derives from a statistical wrinkle ("Paradox lost", September 13th). When production is outsourced to a foreign country (a growing trend in recent years, including in the service sector), present statistical procedures lead to an underweighting of the foreign labour incorporated in imports.

When domestic labour—processing medical-insurance claims, for instance—is replaced by Caribbean or Indian labour at a fraction of the cost, the hours of domestic labour are written off but the hours of foreign labour are not added back. National accounting should pick this up, in the sense that higher imports reduce GDP, but this reduction does not adequately correct for the loss of domestic output. True productivity might well be the same as before (or lower); we shall never know.

Fabrizio Galimberti
Hawthorn, Australia

SIR – For anyone coming to America from Europe, the idea of unmeasured quality gains in services on this side of the Atlantic must seem far-fetched. As a result of high turnover, few if any employees in an average bank branch can handle the most basic questions; taxi drivers often do not know their way nor any Indo-European language; and the time of customers is systematically wasted through automated-telephone systems. This flatters the unemployment and productivity statistics but any sensible measure of quality in services would surely narrow the gap between America and the EU.

Hans-Joachim Voth
Cambridge, Massachusetts

Home to Hungary

SIR – It is curious that Hungary's neighbours are so irked by that country's status law when a similar, more potent, law has affected them for years ("Ditching the diaspora", September 6th). Israel's law of return, established in 1950, allows any Jew to receive Israeli citizenship and offers far more perks for newcomers than Hungary does.

Even countries with enormous Jewish populations—post-Soviet Ukraine included—are willing to swallow the pill. Romania and Slovakia are also indifferent to Israel's law but they seem to fear the arousal of national feelings when it comes to their local Hungarians. The desire to bring Hungarians home is perfectly legitimate. The European Commission, with its supranational fixations, cannot be expected to understand this desire but Hungary's neighbours should respect it.

Gilad Maayan
Kfar Saba, Israel

Cambodia's import "taxes"

SIR – Your article on Cambodia's admittance to the WTO deceptively states that the country "already has an effective tariff of zero, thanks to its long and porous borders and corrupt customs officials" ("Welcome to the club", September 13th). Government coffers may remain empty as imports increase but bribes

taken by corrupt officials act as a tax on imports. This corruption serves to protect the agriculture sector, which would suffer if imports were allowed to enter without the payment of bribes.

Santosh Anagol
New Haven, Connecticut

Shoving Sharon aside

SIR – As the case for the expulsion of Yasser Arafat is reported I cannot help but wonder how it is that the case for the expulsion of Ariel Sharon has not been made in similar vein ("Apocalypse, soon", September 13th). The removal of Mr Sharon (by democratic means, of course) is a more appropriate course of action to take considering the destruction for which he has been responsible on both sides of the conflict.

While Mr Arafat has sometimes used violence to achieve his goal of national liberation of the oppressed Palestinian people, Mr Sharon has succeeded in obtaining destruction not only for oppressed Palestinians, but also for the unoppressed Israeli people through his persistent revenge-led policy. It is time for Israelis to make their case for Mr Sharon's departure from the political scene. Maybe then there will at last be a chance for peace.

Ariel Ezrahi
Jerusalem

Back to front

SIR – In your review of Matthew Parker's "Monte Cassino" ("The worst battle", September 20th), you fail to comment on its grossly misleading subtitle: "The Hardest-Fought Battle of World War Two". After all the fury and horrors of the Russian campaign have been chronicled for a wide public by Richard Overy, Antony Beevor and others, it is unbelievable that Monte Cassino, or any other battle on the western front, could still be seriously described as the hardest fought of the second world war.

Robert Lacey
Vence, France

Park and free ride

SIR – You note several reasons why the International Union for the Conservation of Nature's estimate of the world's land surface protected by parks may be inaccurate ("Guarding nature", September 13th). I would like to add another. As well as artificial inflation by "paper parks", the estimate is arguably too high because many parks in the third world are in a sense "on loan" (often involuntarily) from some of the world's poorest people, and are not, as yet, paid for.

The costs borne by the very poor, as a direct result of western desires for conservation, often go uncompensated, leading to conflict between people and parks. Mechanisms must be found to match these local costs with a global willingness to pay.

Neal Hockley
Fianarantsoa, Madagascar

Brave words

SIR – You describe George Bush's decision to invade Iraq as being both brave and decisive yet you chide him for not following through ("The hard road ahead", September 6th). In light of the Bush administration's current difficulties in Iraq (arising from poor post-conflict planning), your description may have to be revisited. A man who decides to leap out of a plane at 30,000 feet wearing a parachute may well be described as being both brave and decisive. A man who decides to leap without a parachute may be described as decisive but hardly can be described as brave. Foolhardy, perhaps; fatally optimistic, maybe; but brave, no.

Finbar O'Keeffe
Studio City, California

SIR – You ask, “Why on earth can't the world's richest country ensure that Baghdad has water and electricity?” I would answer with the question, “Why on earth can't the world's richest country ensure that it's own children all have health care?”

Karen Apland
Gilroy, California

SIR – You say that Mr Bush took “a brave, decisive step—by invading Iraq...and by cutting taxes”. Undoubtedly, other politicians will rush to follow in his footsteps by bravely flaunting fiscal restraint and conquering weaker nations. God help us if our next president is cowardly enough to cut spending and establish peace.

Eric Grey
Arlington, Virginia

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Fixing Japan

Kill or cure?

Sep 25th 2003 | TOKYO
From The Economist print edition

Junichiro Koizumi has won his party's leadership battle and chosen his own team. Now he must try to revive his country

Get article background

HOPES are faint, both inside and outside Japan. The patient has been bedbound for well over a decade; the usual remedies have failed, and the doctors are still disputing the diagnosis. Such pessimism may explain why Junichiro Koizumi's victory in last weekend's party elections—in what was billed as a battle between a reformer and the status quo—did little to inspire onlookers.

Indeed, on September 22nd, while the newly reinstated Mr Koizumi named an encouraging new cabinet, the markets busied themselves exploiting a slow change of the guard at the finance ministry, which had long been trying to keep Japan's currency weak, by piling into the yen and making quick gains on its rapid rise (see article). Such fast and fleeting opportunities to trade shares, bonds and currencies are all Japan seems to offer the world any more. But economic-policy reform is what Mr Koizumi, his policymakers and the electorate will have to focus on for the next few months.

That debate is only just heating up after Mr Koizumi's successful bid, on September 20th, to secure another term as president of the ruling Liberal Democratic Party (LDP), and hence as Japan's prime minister. His three LDP challengers had attacked his “structural reform” agenda, arguing that instead Japan should rapidly expand its fiscal deficit—already pushing 8% of GDP—in order to boost growth.

Not only did Mr Koizumi win this contest convincingly, but he then stared down those in his party who had supported the man while opposing his policies. Within two days, he had reshuffled both the party's leadership and the cabinet in ways that clearly fitted his own ideas about what must be done. Those ideas are about to come under fire from the main opposition party, the Democratic Party of Japan, which on September 24th completed a merger with the next-biggest opposition group, the Liberals. Mr Koizumi is widely expected to call lower-house parliamentary elections in early November, and the newly emboldened opposition is gearing up to blame the prime minister for doing too little to cope with unemployment and bankruptcies.

Some of his critics are also trying to draw links between these economic hardships and Japan's rising crime rates. (The most recent white paper showed that violent offences, including robbery and rape, more than doubled between 1997 and 2001.) On this issue, however, Mr Koizumi seems on firmer ground. If any link exists between crime and unemployment, the crucial point is surely to increase the

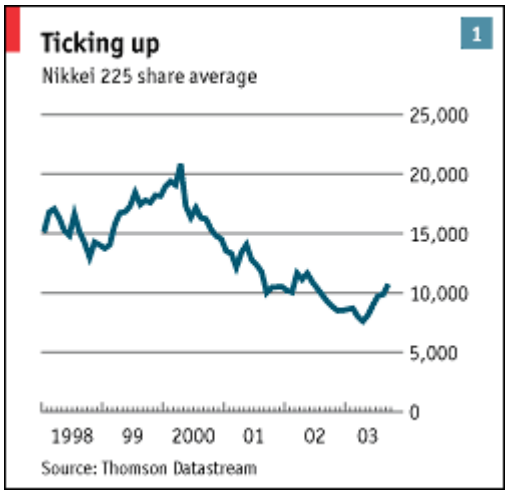
number of jobs available to the young, who make up a disproportionate share of both criminals and the unemployed. And the best way to create more jobs for everyone, he will argue, is through growth. Mr Koizumi must now convince Japanese voters that he can deliver it.

He must also convince the rest of the world. Although Japan's economy is still the world's second-biggest, outsiders pay little attention to it, since the country contributes so little to global growth. Consider, however, just how much economic output is at stake. Between 1997 and 2002—after half a decade of stagnation had already passed, and long after the stock- and property-market bubble had collapsed—Japan's economy actually shrank in nominal terms, from ¥523 trillion ($4.3 trillion) of annual output to ¥500 trillion. Even if it had grown an exceptionally modest 2% a year in nominal terms during that period, it would be 16% bigger now. Cumulatively, it would have generated roughly ¥78 trillion, or more than $650 billion, of additional output.

That staggering sum is several times the estimated cost of rebuilding Iraq, and more than all the rich countries between them spend on defence. Japan's lost $650 billion or so, moreover, is far more wasteful than money that has merely been spent for one bad purpose (rice subsidies) rather than a better one (alleviating poverty). It is potential output that was never produced, which means that nobody, rich or poor, will ever spend it on anything.

Many pundits assume that growth can no longer be revived, or not for several more years. They are wrong. To see why, start with a quick look at recent indicators. Over the past couple of quarters, GDP has perked up a bit. From April to June it actually grew at a 3.9% annual rate, after adjusting for falling prices; even nominal GDP grew during the quarter, at a 1.2% annual rate. Cost-cutting by Japanese companies, combined with low profit margins to begin with, has allowed small increases in sales to generate big jumps in earnings. Operating profits at large firms rose by 17.3% in the fiscal year that ended in March, and have continued to look strong since. Japanese companies have, in turn, been investing some of those higher profits in new machinery and other equipment, giving a fillip to domestic demand.

Pundits either read these signs as evidence that this is a great time to jump into shares (the stockmarket, driven partly by global factors, has risen 38% since April; see chart 1); or they dismiss it as yet another false dawn for Japan's economy, the latest in a series. Yet this debate obscures a simpler observation: that some market forces are still at work in Japan. Price opportunities still lead to bouts of capital spending, and price expectations affect demand. The latest blips on Japan's monitor may be confusing and weak, therefore, but they serve as a reminder that the patient is still alive—and might, with the right treatment, walk again on its own two feet.



First, diagnose

So what exactly ails Japan? Clearly not just the usual sort of business downturn, which can be cured, though painfully, with lay-offs and closures and sometimes with a government shot in the arm. Nor can its chronic weakness be attributed solely to a burst bubble and falling asset prices, though that is clearly part of the problem. Many other countries have been similarly stricken, and have managed to recover. In Japan, the misery has lasted for almost 14 years.

The Economist would like to suggest its own label for Japan's illness. It is “dysflation”: a form of deflation in which dysfunctional economic-policy institutions counteract what would otherwise be good medicine for falling prices. The policies, especially with regard to banks, combine in ways that do more harm than good. More important, policymakers themselves are more inclined to avoid problems than address them; would rather win bureaucratic feuds than co-operate; and base most of their decisions on emotion (such as fear of shame) rather than reason.

It helps to keep all these aspects of dysflation in mind when assessing Japan's problems. Consider, for example, the Bank of Japan. Ordinarily, the best response to deflation—that is, falling prices throughout the economy, and not merely for a few products such as Chinese manufactures—would be lower interest rates and feverish printing of money. Japan has had zero interest rates since

1999, however, and has been boosting the money supply at a rapid clip since early 2001—and prices have continued to fall. According to the most respectable measure, the GDP deflator, they have fallen 7.6% since 1997, and are still dropping fast. Eventually, all the money that the Bank has been printing will be sucked through the financial system and expelled into the economy in the form of higher prices and rising nominal interest rates. But it is taking a perplexingly long time to happen.

The Bank's explanation is that Japan's deflation is a very rare strain indeed. It points to the large quantity of non-performing loans that have piled up in the banking system. Never in the history of human endeavour have so many owed so much for so long. And as the Bank's officials like to point out, new bad loans, at least until recently, continued to accumulate faster than the banks were writing off old ones, and the Financial Services Agency (FSA), which regulates banks, has done nothing to stop this. Banks are lending mainly to their worst borrowers; and with the credit channel not operating properly, the usual monetary-transmission mechanism cannot work either.

There is probably some truth in this argument. What it ignores, however, is the overarching role that expectations—of firms, workers, consumers and investors—play in transmitting the central bank's policies into rising or falling prices, and the need for the central bank to manage those forecasts. The Bank has not only failed utterly in this role, but has refused to take responsibility for trying.

Under the previous governor, Masaru Hayami, whose term began in 1998, every constructive policy that the Bank undertook was undermined by a statement that the Bank did not really expect its policy to get prices rising again, at least not quickly. This had a sort of reverse placebo effect. Even as the central bank was administering potent medicine, Mr Hayami said that it was only doling out sugar cubes. A new governor, Toshihiko Fukui, took over in March, and has been an improvement. Conceivably he will do a better job than Mr Hayami of convincing people that all that loose money will not be vacuumed up again at some point by the Bank. But even Mr Fukui has shown traces of his predecessor's dysfunctional approach.

More government spending?

Since the Bank of Japan is independent, there is not much Mr Koizumi can do about this. Having appointed Mr Fukui, monetary policy is now out of his hands, and the best he can do is co-ordinate more effectively with the central bank. Most of Mr Koizumi's efforts should probably be devoted towards the most harmfully dysfunctional bits of economic policy: ie, those that are preventing the Bank's loose money from generating the inflation that Japan so badly needs.

This may shed some light on arguments over fiscal policy. The case against spending more money seems simple. Japan's public debts have risen sharply over the past decade, and its gross debts, as measured by the IMF, reached 158% of GDP at the end of 2002. The main international rating agencies have downgraded Japanese government debt several times over the past few years. The most visible aspect of Japanese fiscal spending, moreover, is the LDP's addiction to public-works projects, which benefit the party's friends in the construction industry and deliver largesse to small rural districts. Such projects—dams, bridges and roads to nowhere—have continued to get media attention.

Mr Koizumi and his supporters have drawn two conclusions from this. First, they argue, fiscal spending has been tried and has not worked. Second, they say, Japan's debt has now risen to the point where more fiscal spending will merely aggravate the problem by raising the future debt burden, perhaps even harming confidence now. When Mr Koizumi took over as prime minister in April 2001, he pledged to limit new public debt issues to ¥30 trillion a year. Even though he has broken that pledge—this year's fiscal deficit is expected to hit ¥38 trillion—he is still against more public-works spending. He has pledged to privatise Japan's four public-highway corporations, and arranged public hearings last year on their profligacy and influence-peddling.

On further inspection, however, Mr Koizumi's arguments are not as compelling as they appear. For one, Japan's high debt ratios, taken in isolation, do not shed much light on whether more borrowing is a good idea. The gross government-debt ratio ignores many of the offsetting assets of the social security

system, as well as many liabilities held by other public-sector outfits. The IMF reckons that net public debt came to around 72% of GDP at the end of 2002, less than half the gross figure. That is still a high number, of course. And high debt levels should especially worry Japan: since its population is projected to be the world's oldest by 2025, it will soon have to face a massive deficit in its pension system.

Indeed, Japan's problem is not so much its current debt as its future expected liabilities, many of which are being exacerbated by a looming demographic crunch and poor growth. Low growth is the main reason that Japan's debt ratios have deteriorated so badly over the past few years. In 2000-02, for example, tax revenues fell from ¥50.7 trillion a year to ¥43.8 trillion, mainly because of weak demand. The best way to look at Japan's budget, therefore, is to ask whether it is promoting or helping growth. On this question, Mr Koizumi is on weak ground.

It is an exaggeration to say that Japan has exhausted the possibility of using fiscal stimulus to solve its problems. It may have borrowed a lot of money, but much of that borrowing goes towards debt-service payments and social-security transfers, which do not stimulate the economy. Studies by Adam Posen, of the International Institute for Economics in Washington, DC, and several others suggest that when Japan has tried a little stimulus over the past decade it has had an effect. And the fiscal contraction caused by a rise in the consumption tax in 1997 was one of the main reasons why a previous budding recovery ended in a bust.

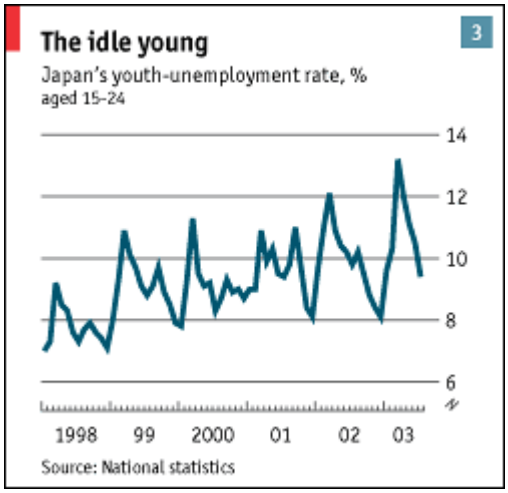
Dealing with the zombies

The question that Japan should be asking, therefore, is not so much whether to spend money, but where. Public-works projects probably help the economy somewhat more than Mr Koizumi and his supporters claim. However, the best use of money would be to tackle the most dysfunctional aspects of dysflation head on. That means doing something about bad loans.

Mr Koizumi is right to focus attention on this problem. So is his main economic-policy minister, Heizo Takenaka, who a year ago was given a second cabinet-level post overseeing the FSA. Mr Takenaka's headline policy, of requiring banks to dispose of their non-performing loans much more quickly, made him the chief target of Mr Koizumi's opponents. Before this week's cabinet reshuffle, onlookers were feverishly speculating whether Mr Koizumi would have to remove Mr Takenaka from at least one of his posts, as part of a compromise to secure re-election as LDP president. That Mr Koizumi did not do so suggests both that he believes he holds a strong hand, and that he is determined to defend his overall approach to the bad-debt problem.

He is right. Bad loans are not just a result of Japan's slump, but a mechanism that is helping to prolong it. Anil Kashyap, an economist at the University of Chicago's business school, reckons that by keeping so-called “zombie” companies alive, rather than letting them die a natural death, the banks and their regulators are allowing too great a burden to fall on more productive companies. Otherwise healthy firms face higher real wages, lower prices and other distortions as a result of this warped competition.

Many of Mr Takenaka's critics complain that writing off more bad loans will lead to more bankruptcies and unemployment. If Mr Kashyap, and many others, are correct about the effects of the zombies, however, then writing off their loans will actually foster the creation of new companies and more productive jobs, as well as boosting output. Since new firms are more likely to hire young workers, there would also be long-run productivity gains. More youngsters would be working in interesting jobs and developing their skills, rather than doing nothing, as too many are now (see chart 3).



So if generating growth is more important than shrinking the budget deficit, and if the mountain of bad loans is hampering growth, why doesn't Mr Koizumi use government money to help the banks write off bad loans faster? That, alas, is not something he has been willing to countenance. In May, the government used some money to rescue a big regional bank, Resona, which suddenly found itself with too little capital on its books. Mr Takenaka's main approach to the banks, however, has been to encourage them to write off loans faster, while presenting them with inconsistent incentives that do not really encourage them to rush.

The best way to cure the patient would be to spend the money now and do the job properly. More money for a social safety net, as the Democrats advocate, might also help to ease the transition as bankruptcies and lay-offs increase and raise unemployment. Haruo Shimada, an academic economist and informal adviser to Mr Koizumi, has summed it up nicely: “If you want to do radical surgery, you need to set aside a big enough supply of blood.”

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About sponsorship

Education reform

Progress and confusion

Sep 25th 2003 | CHICAGO AND NEW YORK
From The Economist print edition

George Bush's main domestic achievement so far has a distinctly Democratic edge

AT FIRST sight, it sounds woefully familiar. The Democrats complain that George Bush has created a costly quagmire. Conservatives say he was not radical enough in the first place. Confusion reigns on the ground. In this case, the battlefield is not Baghdad, but the schoolyard—and, on the whole, the news from the front line is a little more positive.

Last month, more than 47m public-school students trudged back to their classrooms, starting the second year of the president's sweeping No Child Left Behind Act, a 12-year plan to raise national academic standards in America's public schools. The NCLB Act, hailed by Mr Bush as “the cornerstone of my administration”, has tended to be forgotten in all the fuss about the economy and Iraq. But it is a useful reminder of his pragmatic, reforming side.

To get the law through, the president quickly dropped the conservative idea of school vouchers. He focused instead on national standards and increasing accountability—the sort of issues that New Democrats had talked about before, albeit with a wary eye on their party's paymasters in the teachers' unions. Indeed, the NCLB Act bears a striking similarity to an effort by Bill Clinton in 1994.

The starting point is simple enough. By any available international standard, America's public schools deliver poor value for money: they cost a lot and their results overall are dismal. The goal of the NCLB Act, which Mr Bush signed into law in January 2002, is for all students to be “proficient” in reading, mathematics and science by the 2013-14 school year. The bill provides more money for schools, particularly those in poor areas, but, unlike similar efforts in the past 40 years, it ties that money to progress in annual tests.

Underperforming schools face penalties. In the most severe cases (if schools fail to improve after four years), their principals—as Americans call headmasters—can lose their jobs. Schools also have to send parents regular reports, and parents are theoretically given the chance to transfer their child to a better school, or get money to hire a tutor, if their school fails to improve within the first two-to-three years. The administration of all this is left to the states, who are also allowed to define what “proficient” means.

The main success so far has been to make school performance more transparent. The states do not have to start annually testing every student between eight and 14 to the new standards until 2005; but their performance can still be measured by existing mandatory exams. Most children had taken tests of some

sort by spring 2003, and the results have been sent to parents and the press.

In New York City, for instance, parents have been notified that 497 schools, out of the city's 1,200, are “in need of improvement”. For 46 of these schools, this is the second year of underperformance, as measured by previous tests, so students in these schools technically had the right to be moved to a different school.

The results have not pleased everybody. Parents and teachers have complained that not all the “failing” schools deserve that title. In some cases, they blame a quirk that requires schools to break down their test results into “subgroups”, based on factors like race and sex—and to show progress in every category. The idea is to prevent schools neglecting harder-to-teach groups, such as Spanish-speaking Latinos. Yet it also meant that Midwood High School in Brooklyn, which often wins science awards and boasts a high graduation rate, was deemed “in need of improvement” because 33 students with disabilities did not meet the benchmark.

Yet most parents seem to like being able to measure how good their schools are, however crudely. Last month, instead of covering bus routes, the back-to-school stories in local papers reported which schools were on the “needs improvement” list. Across America, parents now ask whether their child's teacher is “highly qualified” and why their school has failed to show “adequate yearly progress”.

Most of the problems have come from trying to implement the various sanctions that follow from the tests. Many of those New Yorkers who “won” the chance to move their children were told this only a few days before the start of the new school year. That can surely be speeded up, but there is also the problem of making space for these transferees at better schools.

In Chicago, for instance, some 270,000 students qualified to transfer this year, but only 1,097 spots were available at better schools. Of the 19,000-odd students who applied, only 529 had enrolled in new schools by September 23rd. The remaining slots will stay empty. Some students who requested transfers have changed their minds, and as it is already the fourth week of the school year, administrators say moving children around is disruptive. Similarly, some 133,000 students in Chicago are eligible for extra tutoring, but city school officials say they only have money to pay for 25,000 to 30,000 of them.

Eugene Hickok, Mr Bush's under-secretary of education, says such numbers are an anomaly that will be ironed out in time. In other countries, the first year of education reform has been fairly chaotic. But Arne Duncan, the chief of the Chicago school system, calls the NCLB Act an “underfunded mandate”: the federal government has saddled the states with a lot of hidden costs to do with setting up the tests and solving the problems the tests reveal.

This may be unfortunate timing as much as anything else. States everywhere are desperate to cut costs, education included. Far from stinting on schools, America spends far more than the international average, and the federal government is spending record amounts on elementary and secondary education. On the other hand, there are definitely schools in poor neighbourhoods that are struggling just to get proper textbooks (while praying for inspiring teachers).

Unsurprisingly, the loudest protests against No Child Left Behind have come from the teachers' unions, which are still talking of filing a lawsuit against the Department of Education. The law's (outrageous) demand that all teachers be qualified to teach their subjects has the union quaking. The teachers say that results can be affected by factors like class size as well as their competency. “I've never known any test to raise any standard,” Reg Weaver, the president of the National Education Association, told *The Economist*.

If testing is a battle the Democrats want, it will surely delight Mr Bush. Voters might ask why teachers should not be assessed as other Americans are in their workplaces. In the longer term, a broader acceptance of the NCLB Act may also give a spur to those who want to introduce even greater accountability in the shape of vouchers that would give parents the power to spend their education dollars where they want to.

On September 24th, a budget bill was introduced into the Senate that included money for a small voucher experiment in the District of Columbia. The idea has the support of the capital's Democratic mayor. Yet most Democratic senators are prepared to filibuster the bill. The Republicans were looking for a compromise as this newspaper went to press.

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About sponsorship

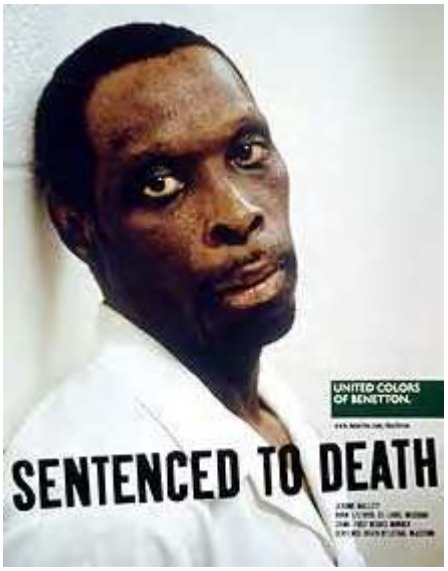
Italian fashion and Texan justice

Dressed to kill

Sep 25th 2003 | AUSTIN
From The Economist print edition

From bright jerseys to last meals

AP



Chic or cheap?

IF BENETTON wanted attention, it has found it. In 2000, the fashion company—famous for putting bloody newborn babies and the dying on its billboards—ran a glossy advertisement featuring inmates from various death rows around America. The ad campaign caused fury for its use of convicted killers as fashion props—and the company apologised to the families of their victims. Now comes the news that Carlo Benetton, the company's deputy-chairman, has quietly sold his 11,000-acre Buffalo Ranch to the state of Texas for use by its prison system, the largest conveyer-belt of death in America.

Mr Benetton had apparently wanted the prime river-bottom land to grow cotton for the company's clothing line, until he discovered that, as a foreigner, he could not get government subsidies. Now the farmland—which lies between Austin, the state capital, and Huntsville, home of the “Walls” Unit death chamber—will produce cotton for prisoners' uniforms and corn for their (last) meals. The large plantation house, complete with swimming pool, will be used as a conference centre for prison officials.

If Mr Benetton had misgivings about selling the farm to purveyors of death, he did not convey that to Tom Fordyce. Mr Fordyce, who runs the Texas prison system's massive farm operations (145,000 acres, 20m pounds of vegetables a year, its own beef and pork processing plants) says the fashion mogul was ready to sell “right on the spot”; “He's a businessman, and this was a business transaction.”

Benetton officials in New York did not return telephone calls. But now that the firm and the Texas prison warders are on such good terms, one can only imagine the advertising possibilities.

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The California recall

After the debate

Sep 25th 2003 | SAN FRANCISCO
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The closer the finish-line, the nastier and more complicated the race gets

GRAY DAVIS governs California without scruples; Cruz Bustamante, his lieutenant-governor, has sold his soul to Indian casino interests; Arnold Schwarzenegger is a politically ignorant masochist; Tom McClintock is a conservative extremist. Or so California's voters are being told, by TV commercials, as the electoral clock ticks towards October 7th. Then they will decide, first, whether to fire Mr Davis, and next whom to put in his place.

Hence the importance of a televised debate on September 24th between the five leading candidates to replace the Democratic governor. Unhelpfully, the two most prominent performers were the ones who have no chance of winning anyway: Arianna Huffington, a British-educated, Greek-accented independent, and Peter Camejo, the Green Party candidate, both have less than 5% in the polls. By contrast Mr Bustamante, who as a good Democrat is supposed to be against the recall, was surprisingly restrained, and Mr McClintock was knowledgeable but a mite too serious for the average viewer.

Which leaves Arnie. The debate represented the best opportunity for his rivals to prove that he was indeed merely a dumb actor. True to that picture, he proved himself more the master of the entertaining one-liner ("You guys have an addiction problem: tax, tax, tax") than the issues. On the other hand, he patently did not lose the debate either, which counts as a sort of victory, and he dominated the post-debate news clips, not least in his exchanges with his main provoker, Mrs Huffington ("I have a perfect place in 'Terminator 4' for you," was one anti-feminist quip).

The real winner from the televised bickering could be the man who was not there: Mr Davis. Last month, according to the pollsters at the Public Policy Institute of California (PPIC), 58% of the electorate would have voted to fire their governor; now the figure is down to 53%. He could also be helped by the typically suicidal refusal of the Californian Republicans to unite behind one candidate. As long as both the conservative Mr McClintock (who had 14% in the poll) and the more moderate Mr Schwarzenegger (26%) remain in the race, Mr Bustamante (28%) will stay favourite to win the second ballot. That may put many Republicans off voting at all, allowing Mr Davis to limp through the first ballot.

At least the candidates all now have a firm finish-line to struggle towards. On September 23rd, a full panel of 11 judges from the liberal-leaning 9th Circuit Court of Appeals slapped down an earlier decision by a three-man panel to delay the vote till March because of faulty voting equipment. "Interference with impending elections is extraordinary," said the 11 judges, "and interference with an election after voting has begun is unprecedented." The court decided that the 40,000 votes that could be miscast were not significant enough, especially since some 670,000 absentee ballots have already been sent in.

So what happens next? In the PPIC poll, one in five voters were undecided about whom to back in the second ballot. In a Democratic state, you would expect Mr Bustamante to hoover up many of them, but his campaign is stalling. His lead over Mr Schwarzenegger, the man he accuses of "living on Planet Hollywood", looks fragile. Now a state judge has ruled that he violated campaign-finance limits by using $3.8m—most of it from Indian gaming tribes and public-sector unions—from an old campaign account.

So the Republicans have a chance if they can unite around a single candidate. Jim Brulte, leader of the Republicans in the state Senate, this week said Mr McClintock's candidacy "puts at risk not only the election of a Republican governor but the recall itself". Darrell Issa, a rich San Diego congressman who bankrolled the recall campaign, said Mr McClintock, before announcing his candidature, had promised to withdraw rather than spoil a fellow Republican's chances—"and I expect him to keep his promise."

In public, Mr McClintock is holding his ground. Ronald Reagan, he points out, was asked to step aside in

the Republican primary for the 1966 governor's race (which he eventually won). On the other hand, Mr McClintock did not attack Mr Schwarzenegger at all in the debate. Some talk of a face-saving compromise: Mr McClintock would officially stay in the race, but tell his supporters to feel free to vote for Arnie for tactical reasons. California's huge economic and social problems may yet land on the Terminator's desk.

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AIDS and abortion policy

Pregnant pause

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From The Economist print edition

How one policy undermines another

IN HIS state-of-the-union message this year, George Bush unveiled a bold new package to fight tuberculosis, malaria and, above all, AIDS, promising $15 billion over the next five years to 14 countries, mainly in Africa. In June, he paraded this pledge at the G8 summit, and in July he pressed it home on a tour of African countries.

Now these pledges are under scrutiny. To begin with, there is the question of funds promised and those about to be delivered. In the new AIDS bill signed by Mr Bush in May, up to $3 billion could be made available for global programmes in 2004. But Mr Bush has requested only $2 billion next year, feeling that may be as much as Africa's health-care infrastructure can absorb. Paul Zeitz, head of the Global AIDS Alliance, a Washington lobby group, calls this “racist misinformation”, and many others, among them 52 African leaders, are demanding the higher figure.

Then there is the issue of condoms. Arm-twisted by conservative Christian lobbyists, the new AIDS bill stipulates that one-third of the funds allocated for prevention progammes must go to those that advocate abstinence—though many public-health experts doubt that “just say no” will do much to halt the spread of HIV.

This conflict is just one of many in the long-running war over funding for foreign family planning. For over 30 years, American law has prohibited the use of federal money to fund abortion activities. Two years ago, Mr Bush reinstated another bit of legislation—the Mexico City Policy, or “global gag rule”—which requires foreign NGOs, if they want American money, to certify that they do not perform or actively promote abortion as a method of family planning, even if the money comes from other sources. At the end of August, Mr Bush ordered the gag rule to be extended to certain State Department programmes.

Many groups, particularly “faith-based” organisations, have signed on to the gag rule, but among those refusing to toe the line are the International Planned Parenthood Federation (IPPF) and Marie Stopes International (MSI) which, between them, run family-planning clinics in more than 180 countries. These groups have long argued that they cannot sign the rule and claim to be delivering the best advice possible to women in poor places if they cannot even mention the A-word.

IPPF has found it hard to make up the money it has lost by its defiance. And this week a new report from Population Action International, a Washington lobby group, offers the first assessment of the impact of the gag rule at the grass roots. In Kenya, for example, both local outposts of IPPF and MSI have had to close clinics, depriving thousands not only of family-planning advice but also of cervical-cancer screening and childhood immunisations. Similar tales come from Zambia, where the country's leading family-planning organisation has lost a quarter of its funding.

By not signing the gag rule, NGOs lose not only USAID money but also contraceptive supplies: by 2002, the global gag rule had led to the loss of American-donated contraceptives, including condoms, to NGOs in 29 countries. And according to Steven Sinding, the head of IPPF, there is no evidence to show that the rule is reducing the rate of abortion; on the contrary, he argues, the lack of contraceptives is more likely to raise the rate of unsafe abortions.

The report also argues that even though the gag rule does not apply directly to HIV funds it undermines the prevention of the disease. In Ghana, for example, almost 700,000 clients are losing access to HIV counselling and testing. Local family-planning groups are essential to tackling HIV, particularly in sub-Saharan Africa, says Jeff O'Malley, head of the International HIV/AIDS Alliance. Women now account for

almost three-fifths of all infections there; and for many young married women, their only access to community health care is the local family-planning clinic. At this week's session of the United Nations General Assembly on AIDS (see article), the point was underlined. Of more than 100 HIV-ridden countries surveyed, UNAIDS found that nearly a third lack policies to ensure that women have equal access to prevention and care.

But those who support the global gag rule are not impressed with such arguments. Chris Smith, a Republican congressman, points out that there are plenty of groups that could replace MSI and IPPF in the field: “we want to make sure a country is abortion free, not moving towards free abortion.” Scott Weinberg of the Population Research Institute, argues that MSI is actually promoting the spread of HIV in “filthy clinics” that mix infected and non-infected women. MSI dismisses this charge as “arrant nonsense”.

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The Louisiana governor's race

The Cajun, the virgin and Spa Boy

Sep 25th 2003 | NEW ORLEANS
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A motley crew contends to be the next governor

THE billboard, on a busy highway just west of New Orleans, sent chills up the spines of Louisiana's businessmen and politicians. A fast-growing school district outside Houston was touting for teachers, offering "$40K a state away". That is about $10,000 more than most districts in Louisiana offer their first-year teachers. The state's next governor will have to face every problem implied by that poster: a brain drain, a troubled public-education system and an economy that cannot generate enough investment to thrive.

For years, Louisiana depended heavily on oil extraction for jobs and tax revenues, but those happy days ended in the 1980s. Over the past quarter-century, its population has grown more slowly than in any other state in the South, more slowly even than parts of the Rust Belt. And as Louisiana's much-scorned eastern neighbours continue to add car-manufacturing jobs, even the old jibes "Thank God for Mississippi" and "Thank God for Alabama" are losing their power to console.

AP

Jindal on the rise

Fortunately, politicians are at last acknowledging the problem—as the gubernatorial contest shows. In 1991 and 1995, the contests turned on racial divisions, political scandals and gambling. The 1999 contest, won easily by the Republican incumbent, Mike Foster, was a more civilised affair. This year's primary, set for October 4th, has followed this trend: the main issue is the need to revive the state's economy and stop young people leaving.

That does not mean that the primary lacks colour. Getting on the ballot in Louisiana is even easier than in California's recall election. Among the 18 hopefuls vying to replace Mr Foster, who cannot run again, are a landscaper who promises to cut the grass at the governor's mansion and a 37-year-old male virgin who would create jobs by running a nationwide search for a first lady.

In Louisiana, all candidates of all parties run in a first primary election, and, if nobody gets more than 50%, the first two meet in a run-off. This tends to favour the most liberal Democrat and the most conservative Republican.

Kathleen Babineaux Blanco, the lieutenant-governor, looks the best bet to nab the Democratic slot. Ms Blanco is on the dull and platitudinous side, but she goes down strong in Cajun country, as her maiden name suggests, and runs the tourism department, which allows her to take credit for one of the state's few growth industries.

The other Democrats include Richard Ieyoub, the attorney-general, who is trying to shake off his image as the trial lawyers' candidate, and Buddy Leach, an ex-congressman running on an unabashedly populist platform: pay-rises for teachers, tax exemptions for the elderly, and a tax on foreign oil. Randy Ewing, a former president of the state Senate, has a record of supporting education and tax reforms, and vows to create 200,000 jobs; but he may be too moderate for this race.

On the Republican side, Jay Blossman, a state utility regulator, is evidently aiming for the title of Most Conservative Republican; he has run ads singling out a well-known black politician for wasting state money. But revelations that power companies have given Mr Blossman freebies, including a $564 visit to a New Age health resort in New Mexico, have earned him the nickname "Spa Boy". Also lagging is Hunt

Downer, a state representative and former Democrat backed by much of the Republican establishment. Sadly for him, the bigwigs in his new party almost always bet on the wrong horse.

To the surprise of most pundits, the Republican frontrunner is Bobby Jindal, a 32-year-old Indian-American Rhodes scholar and former consultant at McKinsey—hardly the standard profile of a Louisiana governor. After Mr Foster made him secretary of the state's scandal-plagued health department in 1996, Mr Jindal led a crackdown on fraud and abuse. Critics question his attention span: he left Baton Rouge to head a federal Medicare task-force, returned to lead a university system in Louisiana and then left again to work for the Bush administration. Still, Mr Foster is supporting him, and Mr Jindal has run a clever campaign. One recent poll showed him two points ahead of Ms Blanco.

Whatever the differences among the candidates, many of their promises sound the same. At present, when companies borrow money to pay for capital improvements, Louisiana taxes the debt as if it were income. All the main candidates promise to get rid of such disincentives, and to be more aggressive than the travel-averse Mr Foster in schmoozing with corporate executives. But other changes won't come easily. The state tax code exempts from property taxes the first $75,000 of the value of any owner-occupied house, thereby pushing the burden on to businesses and renters. Destructive as it is, that exemption is politically untouchable.

It will certainly need decades of honest, uneventful, boring governance to remove the state's other black mark with investors—its reputation for shakedowns and political scheming. But Louisiana has some advantages, including low labour and housing costs, an inviting cultural climate and a convenient site at the mouth of America's most important river. A good governor could still stop people voting with their feet.

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Bounty hunters

Wanted, dead or alive

Sep 25th 2003
From The Economist print edition

Are bondsmen and bounty hunters a good thing?

FOR most people, bounty hunters conjure up images of wild-west loners chasing cattle thieves for a handful of dollars. The recent exploits of Duane “Dog” Chapman—a particularly colourful specimen of this unusual profession—have done little to alter the loose-cannon image. Last June, Mr Chapman tracked down Andrew Luster, a Max Factor heir convicted of rape, to Mexico—and hauled him back to California, to the fury of the Mexican government. Yet most bounty hunters have a much more mundane life.

Nowadays, bounty hunting (sorry, bail enforcement) is closely linked to the bail-bond industry. Under American law, most people arrested for minor crimes can get out of jail and wait for their day in court in the comfort of their home if they put up bail money, which is returned when they appear in front of the judge. Those who don't have the cash often turn to bail-bond agents or “bondsmen” (though many seem to be women). For a premium, and usually some collateral, agents guarantee that their clients will appear in court and cover their debts if they do not. Around nine in ten bailees follow the rules, and only a tiny proportion of the absentees are genuine fugitives (most simply forget, or are ill, and the date is rescheduled).

AP

A Dog that hunts alone

Whenever one of their *protégés* jumps bail, some agents turn to independent bounty hunters to round them up for a share of the bond value. Making a living as a freelance bounty hunter, however, is not easy. “It is chicken today, and feathers tomorrow,” says Billy Wells, a bounty hunter based in San Antonio, Texas. In some states, such as Florida, independent bounty hunters are actually illegal. Even when they are not, most bail-bond agents do the tracking down themselves.

According to the Professional Bail Agents of the United States, an association based in Washington, DC, only 1,200 people claim to be independent bounty hunters in the United States, and probably fewer than 100 manage to make a living at it. “This is a weekend activity, like hunting or fishing,” explains Mr Wells, who is also a bondsman, in his Texas drawl. He offers a two-day training course for would-be bounty hunters but strongly advises his students to keep their day jobs, or to double as bail-bond agents.

There are about 14,000 bond agents in the United States, bailing out hundreds of thousands of people every year. Most cases seem to involve drunk drivers and wife-beaters, and the average bond is $2,000. Most agencies are small “mom and pop” operations, run with a handful of employees.

Linda Braswell, a mother of six, has been in the business for 34 years. She works out of Florida with her husband, son, daughter and nephew. The key to a successful bail-bond business, says Mrs Braswell, is to know whom you're dealing with, which requires strong roots in the community. “This is not a job,” she explains. “This is a way of life.” Bond agents often have to be available 24 hours a day, seven days a week, as many clients fail to get arrested during office hours.

Fees are usually regulated (normally, they are around 10% of the bond value), so service and a personal touch make a difference. The offices of Bail Busters, a Los Angeles firm, are conveniently situated next to the city's main jails: after the firm gets your loved ones out, it graciously offers to drive them home. All major credit cards are accepted.

On the whole, bail-bond agents tend to work closely with the police, often bringing them in to help with

arrests. When one of Mrs Braswell's clients fled abroad, she worked with the Australian police, the State Department and the local sheriff to bring him back. Most fugitives do not make it that far, however. “They are often idiots,” explains Mr Wells.

Bail-bond agents claim that they save the police time and effort. Critics, however, claim that they are unnecessary and dangerously unregulated. In most federal courts, defendants are policed by different methods, such as electronic tagging or home detention. John Zwerling, a board member of the National Association of Criminal Defence Lawyers, argues that the bail system imposes an unnecessary cost on defendants, which can undermine their ability to organise their defence.

In the name of the law

The powers enjoyed by bond agents and bounty hunters also raise some eyebrows. They can search their clients' houses without a warrant, as well as arrest them outside a state's borders. The agents explain that their clients, by entering into a bail-bond contract, give them the right to do so. But, as Mrs Braswell admits, there are also a few unscrupulous agents who give her trade a bad name. Abductions have occurred, as well as illegal break-ins.

Regulation of bail agents and bounty hunters is left to the states. Most now require bond agents to get a licence, but beyond that things tend to get fuzzy. A handful of states do not allow private bail bonds at all. Some do not allow independent bounty hunting; others give the bounty hunters more freedom than the bail bondsmen. So chasing fugitives across state lines can turn into a legal minefield.

This is a lesson Mr Chapman should have learned by now. Having failed to obtain proper authority for his spectacular capture of Mr Luster, he was denied any bounty and faces misdemeanour charges in the United States.

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Lexington

Taming the octopus

Sep 25th 2003
From The Economist print edition

Condoleezza Rice tells you what the president wants. Don't knock it

WHO runs foreign policy? In most countries, the answer would be simple: the foreign minister, with the head of government keeping watch. In America, nothing is that intelligible. As befits a power with the reach of an octopus, the foreign-policy process looks a bit like an octopus too.

Tentacle one is the State Department, with Colin Powell the nation's chief diplomat. Tentacle two is the Pentagon, where Donald Rumsfeld directs American soldiers around the world. Tentacle three is the Central Intelligence Agency (plus innumerable small spy-shops). Both houses of Congress claim a role in foreign policy and like to wave their arms around, too.

This unwieldy system goes by the name of the inter-agency process. And the person supposed to be in charge of it is Condoleezza Rice, the head of the National Security Council (NSC), the White House's own foreign-policy team. Her job is to mediate between warring departments and agencies, present their views to the president, develop a policy out of the mess and ensure that other people implement it.

Ms Rice is having a rough time. “The inter-agency process is completely dysfunctional,” one former (Republican) cabinet secretary told the *Washington Post*. Others say that Ms Rice has lost power, that she can't control experienced barons like Mr Rumsfeld, Mr Powell and Dick Cheney in the way that Henry Kissinger did. Is it true?

There are certainly problems aplenty. Post-war planning for Iraq was pathetic. The president included false claims about Saddam Hussein's purchases of uranium in his 2003 state-of-the-union speech. Congressmen and foreigners complain that Mr Rumsfeld and Mr Powell are always contradicting each other. Decisions taken at the top get stifled further down the bureaucracy. And so on.

Some problems were inevitable. In the past two years, America has weathered its worst terrorist attack, fought two wars and seen the worst outbreak of transatlantic bad temper in decades. As one official puts it, these are life and death issues that would have strained any policy-making process. Even so, the Bush team seems unusually fractious. In most administrations the secretaries of state and defence are at each other's throats, but the current two are particularly murderous. Mr Rumsfeld, a champion bureaucratic scrapper, has used the wars in Iraq and Afghanistan to grab a bigger role in foreign affairs. Meanwhile, Mr Cheney has created his own foreign-policy staff, producing competing institutions within the White

House. Mr Cheney attends meetings of “the principals” (Ms Rice, Messrs Powell and Rumsfeld), which previous vice-presidents did not.

In contrast, Ms Rice has gone out of her way not to be seen as the equal of these bureaucratic bullies. She told Bob Woodward (in “Bush at War”) that she did not want to impose her views, but preferred to act as an honest broker between the others—like Brent Scowcroft, who did the job for George Bush's father.

Yet Ms Rice has more than either Mr Powell or Mr Rumsfeld of the most precious commodity in Washington: the president's time. She often spends weekends at Camp David with the Bush family, and is probably closer to Mr Bush than any NSC chief has been to any recent president. And she uses this influence, often decisively. One distinguishing feature of the arguments over Iraq is that the “powerless” Ms Rice has always been on the side that has won. She sided with Mr Cheney and Mr Rumsfeld when Mr Bush embraced the wider goal of changing the Middle East; she sided with the internationalist Mr Powell and the generals when he persuaded Mr Bush to go back to the UN.

Looked at from this perspective, the inter-agency process looks less chaotic. “There's a lot of chatter,” says one insider, “but it's really not worth the time.” If the principals argue a lot, the underlying reason is not because Ms Rice is overawed, but because the president likes it that way. Although famously intolerant of any sign of disloyalty, Mr Bush has no problem with his Titans clubbing each other until he makes up his mind and steps in. When he makes his move—for instance, over the recent decision to go back to the UN—the Titans are expected to fall into line, as Mr Rumsfeld has.

The dangers of withdrawal

This manner of decision-making is confusing, but it has virtues, too. Ms Rice's withdrawn role allows Mr Bush to call on advice from internationalists such as Mr Powell as well as conservatives like Mr Cheney. It also means that policies can be readjusted. The new move on Iraq may not work, but the White House has managed to avoid two even more dangerous alternatives: being locked into one unchanging position, or having rival opinions cancel each other out so nothing gets done.

But has Ms Rice taken her role as policy adjudicator too far? The mess in Iraq may stem indirectly from a decision she took shortly after coming to the White House. Ms Rice thought Bill Clinton had centralised too much power in the relatively small NSC, and sensibly decided to delegate more of the implementation of policy back to departments such as state and defence. But she gave away too much, allowing policy to be formulated as well as implemented elsewhere. It was this mindset that allowed Mr Bush to put the Pentagon in charge of reconstructing Iraq. This gave the operation clarity of command, but the Pentagon knew precious little about running, say, Iraq's finances; a more interventionist NSC would have spread the burden.

And what about Ms Rice's own prospects? Uniquely among Mr Bush's foreign-policy team, she has the potential for a separate political career. So far, she has done what the president has asked of her. One might be more sanguine about the thought of a President Rice if she were to grab hold of policy making more and let the tentacles writhe around less.

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Canada's political transition

Paul Martin's tall agenda

Sep 25th 2003 | MONTREAL, OTTAWA AND TORONTO
From The Economist print edition

AP

The Liberal hegemon marches on, but circumstances may require the new leader to embrace change as well as continuity

Get article background

LAST week, on the second day of the new parliamentary session, Canada's right-wing opposition went for the jugular. It denounced Jean Chrétien's Liberal government for what one opposition leader called an "activist assault on marriage" in the form of a bill giving legal status to unions between two people of the same sex. The opposition scored a moral victory: its motion won the support of backbench Liberals, and failed only narrowly.

But the debate in the gothic Commons chamber in Ottawa, a less claustrophobic but no less rowdy clone of Westminster, served to show the opposition's own marginal status. According to the opinion polls, a narrow majority of Canadians back same-sex marriage; among younger and urban voters, far more do. In choosing the issue for its showpiece debate, the opposition underlined that on the main battlegrounds of politics, on issues of money, the Liberals are dominant.

That dominance is based on Mr Chrétien's success, in a decade in office, in sorting out Canada's public finances without abandoning its welfare state. In 1993, Canada's fiscal deficit stood at 6% of GDP and public debt totalled 64% of GDP. By 1997, the budget was in balance, and deficits were going out of fashion in the provinces. Mr Chrétien achieved this partly be retaining an unpopular sales tax introduced by his Conservative predecessor. But he also slashed defence spending, foreign aid and transfers to the provinces, for health and other services. As economic growth returned, the government began cutting taxes and repaying public debt (which now stands at 40% of GDP) while restoring some of the cuts.

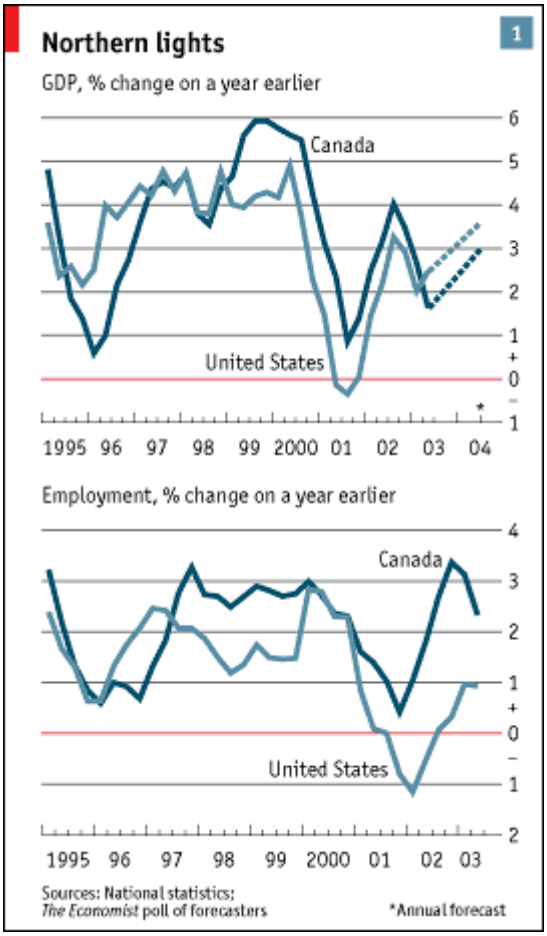
This was a double act between Mr Chrétien and Paul Martin, his finance minister from 1993 until last year. In political terms, it has been highly effective. "Our success is that we've covered such a wide ground in the middle," Mr Chrétien told *The Economist*. "A right-winger who wants a balanced budget can't complain at me. If on the left you want more money for health and education, you're happy too. That makes it very difficult for the opposition." Indeed so, though the opposition, split four ways and lacking national reach, has added difficulties of its own.

Partners to rivals

Partners in government, Mr Chrétien and Mr Martin are personal rivals. Many Canadians believe that Mr Chrétien, who has been the target of small-scale corruption allegations (which he denies), should have stepped down earlier. His departure is an awkwardly lengthy one: he is not due to go until February. But all his efforts to block Mr Martin have failed. Last weekend, Liberals chose the delegates to their leadership convention, due in November. Some 90% of them are known to be supporters of Mr Martin, with only 10% backing Sheila Copps, a nationalist from the Liberal left who is his only remaining rival.

Mr Martin's arrival will herald a personality change at the top. Mr Chrétien, a federalist Quebecker, is a skilled and instinctive political fighter whose antennae are tuned resolutely to Canada rather than the world. Mr Martin, an Ontarian who speaks fluent French and whose political home is in Montreal, has broader experience. He entered politics only after building a shipping business. He is often said to be further to the right than Mr Chrétien. But a new book* by a Canadian journalist describes a more complex figure: a gregarious technocrat, almost Clintonian in his intellectual interests if not in charisma. As the son of one of the Liberal founders of Canada's welfare state he is less conservative than he looks. He has a reputation for competence, but some detect a tendency to dither.

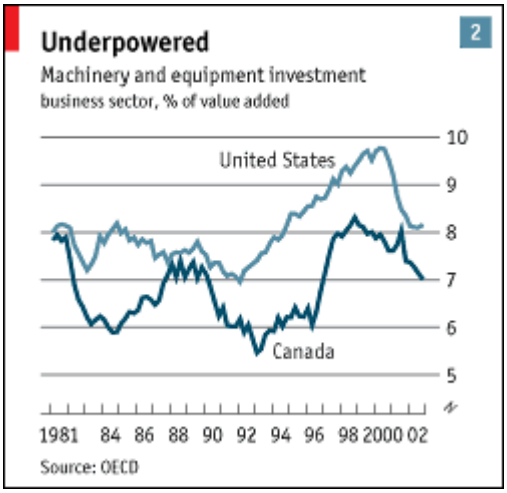
Will policy change, too? Mr Martin faces an agenda that is more challenging than many Canadians might imagine. It can be summarised under four, overlapping, headings: the economy and the public finances; federal-provincial relations; immigration; and foreign policy.



Take the economy first. Canada has competed successfully with the United States (see chart 1) partly because of lower wages and a weaker currency. If it is to close the income gap that still divides the two countries, as Mr Martin says he wants to, it needs to raise its productivity further. Canadian workers are less productive because businesses invest less than their American counterparts (see chart 2, below).

“Canada has a small, dispersed population and a cold climate. In North America, the United States has a huge market and Mexico has lower costs. So we have to have better public policies to tilt towards Canada,” says Jack Mintz of the CD Howe Institute, a Toronto research centre. Canada has something of an edge in education and health: for now, at least, the extra cost in taxes of Canada's public health system is similar to the health-insurance contributions made by American firms, says Mr Mintz. But despite cuts in corporate income tax, Canada's tax system still penalises investment. There are also legal restrictions on foreign investment (in banking, for example) which some would like to relax, but others argue are needed to defend Canadian national identity.

Fiscal imbalance



Tax cuts are only one among many claims on the public purse. Perhaps the most pressing is the increasingly expensive health service, enshrined in the Canada Health Act. In February, Mr Chrétien agreed to increase federal health spending, by more than C$30 billion ($20 billion) over five years. But the provinces, which are responsible for health and education, still complain of a “fiscal imbalance”. All of them except

energy-rich Alberta are poised to sink back into deficit, according to Hugh Segal of Montreal's Institute for Research on Public Policy. He says that health costs, which now account for about 50% of spending by the provinces (excluding debt payments), are “crowding out” other spending needs. Jean Charest, Quebec's new premier, wants a new Council of the Federation, at which the provinces would push Ottawa for further devolution. Meanwhile, big-city mayors, an impotent bunch in Canada, want a slice of the federal petrol tax.

Some Canadians argue that it was Mr Chrétien, rather than his finance minister, who was the fiercer fiscal hawk. But on the public finances, Mr Martin insists that he will “stay the course”; he wants public debt to be “no higher than 25% of GDP”. He also opposes more devolution, except of provincial powers to the cities. But maintaining the balancing act of economic growth and welfare provision may require more radical measures.

One solution would be to allow private health provision for the rich. That would create uproar. “It would be easier to campaign for a change in the Ten Commandments than in the Canada Health Act,” says Mr Segal. So provinces will have to seek innovative ways of doing more with less. Marginally more feasible might be to tinker with the formula (“equalisation”) under which money is shunted from rich provinces (Alberta and Ontario) to poor ones (the rest). This formula is a monument to the principle of universal public service: it encourages the unemployed in depressed areas such as Nova Scotia to stay at home on provincial welfare rolls rather than move in search of a job.

That is all the more ironic since Canada faces skill shortages. The solution has been large-scale immigration (230,000 immigrants arrived last year, in a country of 31.5m people). Nowadays, most are Asians, rather than Europeans. Denis Coderre, the immigration minister, insists the policy enjoys support across the political spectrum and is essential to maintain economic growth and social benefits. “We're a land of immigrants. It's the Canadian way,” Mr Coderre says. Even so, Canada risks a backlash next time the economy cools. Already, there are signs that recent migrants are not doing as well as their predecessors—even though Canada selects most of them for their skills. “There is discrimination, there is racism. We're too polite to talk about them,” says Usha George, who teaches social work at the University of Toronto.

Lastly, some Canadians fret that their country is losing its place in the world. That argument looks exaggerated, except in one respect. Canada's defence spending has slipped to embarrassing levels. Even had the government and the country wanted to take part in the Iraq war (neither did), Canada would have been hard put to make a meaningful contribution (though it has 2,000 troops in Afghanistan). Berel Rodal, a banker in Ottawa, puts it this way: Canada has become “the world's biggest suburb, a wealthy place that worries about schools and parks” while leaving the “downtown issues” of defence and nuclear proliferation to others.

According to Mr Martin, Canada's “number one challenge is keeping that American border open.” Mr Chrétien's relations with George Bush have evolved from distant to bad. That is partly because he made little effort to explain his Iraq policy to Canada's main trading partner. Since September 2001, the government has worked with its American counterpart to improve border security without disrupting trade. But Mr Martin wants closer ties, between legislators in each country as well as officials. He also talks more vaguely of trying to set up new international bodies to tackle issues such as migration and disease. And he wants Canada to be more active in trading with China, India, Brazil and Russia, where he sees an opportunity to lessen his country's dependence on the American market.

For now, Liberal hegemony looks as secure under Mr Martin as under Mr Chrétien. Traditionally, Canadians have balanced their politics by ensuring that their province is governed by a different party than that in power in Ottawa. This balance is breaking down: this year the Liberals seized Quebec, and look poised to win Ontario from the Progressive Conservatives (Tories) in an election on October 2nd.

The prospect of years more of opposition has pushed two conservative parties, the Western-based Alliance and the Tories into a fresh round of merger talks this month. Unity would be hard: the Alliance is conservative on the social issues that dominate the headlines in Canada, and the Tories are not. But Mr Martin would be unwise to assume he will lack opposition for ever. The better life in Canada gets, the harder it may be to keep it so.

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*“Juggernaut: Paul Martin's Campaign for Chrétien's Crown”. By Susan Delacourt. Published in October 2003 by McClelland & Stewart, Toronto.

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Brazil, Argentina and the IMF

Hard or soft?

Sep 25th 2003 | SÃO PAULO AND BUENOS AIRES
From The Economist print edition

Argentina's defiance of its creditors has not eased Brazil's financial dilemmas

AFP

Kirchner squeezes, Lula finesses

NÉSTOR KIRCHNER, Argentina's pugnacious president, is making life awkward for his opposite number in Brazil. Earlier this month, he briefly stopped repaying a loan from the International Monetary Fund and was rewarded with a new credit on easy terms. This week he demanded that private creditors swallow a 75% write-down in the value of debt on which Argentina defaulted in 2001. That would be the biggest “haircut” in the recent history of debt restructuring.

All of this puts pressure on Brazil's left-wing president, Luiz Inácio Lula da Silva. Brazil's $30 billion IMF agreement expires in December. Should he follow Argentina's bold example, by demanding more flexibility from the Fund, or even forswear an agreement altogether? Brazil's recession and Mr da Silva's own history of IMF bashing make either of those options tempting. But the odds are that he will resist.

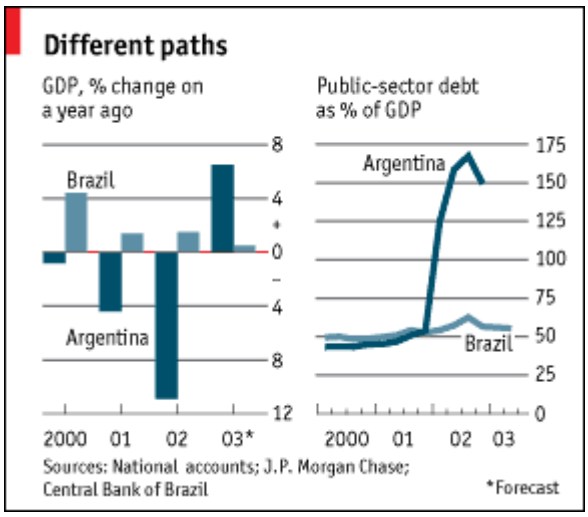
Mr Kirchner's priorities are political legitimacy and economic growth. He won the presidency last April with just a fifth of the vote. His tough line has made him popular without, so far, hindering the economy's recovery from a catastrophic slump. Argentina's latest proposal would still leave it with a colossal debt: the full 75% write-down on bonds worth $87 billion would cut the public debt from 140% of GDP to a mere 90%. Yet, predictably, it has infuriated creditors (“scandalous” said the head of an Italian bondholders' group).

But the bondholders were already mad, and Mr Kirchner reckons that the recovery does not depend on their early return. Some Argentines have begun investing (though investment stands at half its peak level of 1998). Officials believe that domestic consumption can drive the economy for a year or two, and that investor-friendly reform can come later.

Argentina has already paid a high price for its financial irresponsibility. In contrast, Mr da Silva, a popular president with a strong mandate, has staked Brazil's economic recovery on credibility. Mr Kirchner makes this look uncool, but it seems to be working. Since taking office in January, Lula has convinced the markets that he will not default on, or recklessly add to, Brazil's $285 billion public debt. The currency has strengthened, allowing inflation and interest rates to fall, reducing the debt burden and making an economic recovery possible. Loss of credibility would throw this virtuous cycle into reverse.

The trouble is that the recovery has not yet appeared. Brazil's economy shrank in the first half of 2003. Growth is forecast at 3% next year, not enough to create many jobs. “Lula can have one year of recession,” says Paulo Nogueira Batista, an economist at Fundação Gétulio Vargas, a business school. “Two years, and the government's over.”

The answer, many people think, is “flexibility”. Brazil has promised the IMF that it will run a primary fiscal surplus (before interest payments) of 4¼% of GDP. That stops the government from spending its way out of recession, limits help for the poor and restricts public investment. Argentina convinced the IMF that its fragile economy could bear a primary surplus of no more than 3% of GDP next year. Perhaps the new leniency will apply to Brazil.



If so, it would take another form. One suggestion is not to count as government spending some investment by public-sector companies (an exemption that already applies to Petrobras, the oil monopoly). The idea would be to allow more spending on infrastructure, which Brazil sorely needs, without breaching the IMF agreement. Horst Köhler, the IMF's chief, has hinted that the Fund might allow some slack for additional public investment.

Francisco Pires de Souza, an economist at Rio de Janeiro's Federal University, argues that Brazil should disengage from the IMF in order to be free to reduce the primary surplus when it sees fit. With lower interest rates, Mr de Souza argues, this could be done without raising debt as a share of GDP, the variable that matters most for stability in the long run. No one is suggesting that Brazil play Kirchner-style hardball. Mr Batista predicts “a cautious shift from emphasis on credibility to emphasis on growth, which will be endorsed by the IMF, with or without an agreement.”

Such a shift, however cautious, would be risky. “The markets would react badly” to tinkering with the fiscal target, such as by unleashing spending by state owned companies, says Marcelo Carvalho of Itaú Corretora, a brokerage firm. The government looks likely to reject this course. Brazil must improve “its real accounts, not its accounting techniques,” declared the finance minister, Antônio Palocci, at the IMF meeting in Dubai this week.

But credibility may not require an IMF deal. For the first time Brazil is negotiating without the compulsion of a financial crisis. It remains vulnerable to the markets' whims: 75% of federal domestic debt is linked either to interest rates or the dollar, and it must roll over some $30 billion of external debt next year alone. But the IMF's cash is no longer the only form of reassurance the markets will accept.

Armínio Fraga, a former central-bank president, argues that Brazil can add to its stock of credibility more quickly if it breaks free of the IMF. He thinks that investment will take off when investors believe “that Brazil has embraced sound macroeconomic policies out of its own understanding” that they are the way to promote growth. “Not renewing the [IMF] agreement would be a signal of that.”

Against that, a new deal would keep foreign-exchange reserves high, allay lingering investor mistrust and shield Brazil from unexpected shocks. “Cosmetic changes” in the terms, such as inserting targets for social spending, could make an IMF deal more palatable politically, says Maílson da Nóbrega, a former finance minister who now runs Tendências, a consultancy. He expects Brazil to sign a new one-year agreement for less than the IMF lent last year. “A year from now we won't need it any more.” Either way, if Brazil sticks to its economic plan, it will not be an IMF customer for much longer. Then it will be Mr Kirchner's turn to squirm.

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About sponsorship

China

Rich man, poor man

Sep 25th 2003 | BEIJING
From The Economist print edition

ROPI

Income inequality, especially between town and country, has risen sharply in China. This points to serious underlying problems

Get article background

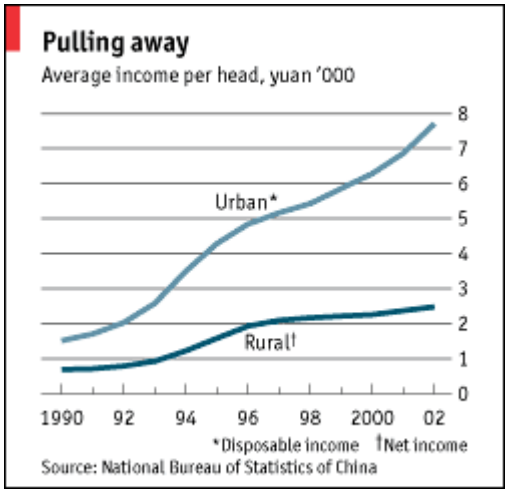
CHINA can be justly proud of having lifted some 400m people out of poverty in the last quarter of a century. But at the same time it has produced income inequalities that are among the fastest-growing in the world. These are not just the natural consequences of China's impressive growth. They are symptomatic of barriers to labour mobility and other legacies of the old planned economy that could put a brake on the country's development in the coming years. For China to reach its target of quadrupling 2000's national product by 2020, it will need bold reforms in a wide range of areas. It is not clear that it has the stamina for them.

At the start of China's move away from central planning in 1978, the average income of urban residents was about 2.5 times that of their rural counterparts. By the mid-1980s, the ratio had narrowed to 1.8, thanks to the breaking up of the people's communes, and other policies aimed at boosting rural incomes. But since then, the countryside has fallen ever further behind. Rural enterprises began to sputter in the 1990s as a result of increasing competition from the cities, bad management and poor investment decisions. Income from farming stagnated. Now urban residents earn on average three times as much as those in the countryside.

The disparity may be worse than it seems. Some Chinese scholars believe that official figures overstate the disposable income of farmers, who have to buy seed and fertiliser and are subject to numerous illegal levies by local governments, and understate that of urban residents, who often have undeclared sources of income. Lin Tai, a social-sciences professor at Beijing's Tsinghua University, has estimated that the urban/rural income ratio is as high as six. A similarly sharp divergence has occurred between the wealthy coastal provinces and the backward interior.

The widening income gap is often described by Chinese officials as a threat to social stability. “A Study of Mass Incidents”, a book circulated last year within China's police force, said that large-scale public disturbances were increasing annually, particularly in the countryside. One of the reasons the study gave for this was the growing gap between rich and poor. But such incidents have

had little perceptible impact on China's overall social and political stability. A bigger potential threat is likely to come from the impact on China's economic growth of the factors that have caused China's urban/rural divide to expand at such a pace.



Thanks to what was until recent years a rigid system barring rural dwellers from moving into the cities, China's rural population is unusually large for a country at its stage of development. About two-thirds of the population of 1.3 billion lives in the countryside or in rural townships. Of these, more than 300m have little or nothing to do. To increase returns on agriculture and boost incomes farmers' tiny plots of land need to be merged and surplus labour moved into urban manufacturing.

China has gradually relaxed restrictions on mobility to meet demand for unskilled labour in the cities. But indirect obstacles remain. These include a lack of affordable housing, exclusion from urban welfare provisions, high fees for work and residence permits and the lack of any mechanism for selling or mortgaging land-use rights (the government formally owns all land) to provide the cash to move.

Removing these obstacles will take daring. Officials worry that in the absence of rural pension or unemployment benefits, allowing farmers to trade their land would deprive them of their only security—potentially creating a new source of social instability. Local governments fear that further encouraging the migration of rural labour would put excessive pressure on urban services.

China recognises the need for faster urbanisation. But fearing the development of sprawling shanty towns around big cities, it has focused on developing smaller towns. In a report published in July, a researcher from the Ministry of Labour and Social Security, Guo Yue, argued that by forgoing economies of scale, China's urbanisation policy had led to a colossal waste of resources and had failed to boost growth or employment.

For cities to work better, they will need industries with increasingly skilled labour and higher technology to boost productivity. Yet China's education system is woefully inadequate. Katarina Tomasevski, a UN official responsible for education rights, said in Beijing last week that Uganda was doing better than China in guaranteeing the right to education. She said China spends only 2% of its GDP on education (China says it is 3.4%, but the UN recommends 6%) and the government provides only 53% of school funding, lower than most other countries with compulsory education systems.

China will also need to overhaul its banking sector, so that capital can be deployed where it is needed instead of in unproductive state-owned enterprises or property speculation. This will involve liberalising interest rates and allowing greater private ownership of banks. But for years China's leaders have dithered over these and other essential reforms, such as sorting out the banks' huge portfolios of bad debt, fearful that a wrong move might precipitate an economic or social crisis.

In a critical report, the World Bank says it will take “enormous political will” for China to overcome resistance to needed reforms. Encouragingly, China supported the report's publication. And next month the Communist Party is scheduled to hold a meeting of its Central Committee to discuss, among other things, speeding up reform—with due attention paid to stability. But don't expect much to change.

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East Asia's oil

Your pipe or mine?

Sep 25th 2003 | BEIJING
From The Economist print edition

China and Japan seek Russia's oil

BACK in April, China thought it had struck a deal with Russia to build an oil pipeline from Angarsk in eastern Siberia to the Chinese oil city of Daqing. The $2.5 billion project would help to reduce China's dependency on Middle Eastern oil and be a symbol of the new friendship established between the former enemies. But China is now worried that its “friend” may have been seduced by a rival scheme proposed by Japan.

Russia's prime minister, Mikhail Kasyanov, said after talks with his Chinese counterpart, Wen Jiabao, in Beijing this week that Russia would uphold its commitments to supply oil to China. But he said consideration of the 2,300km (1,430 miles) pipeline to Daqing would be delayed for three or four months to assess the environmental impact. He offered no assurance, in public at least, that Russia would reject the proposal that Japan has been lobbying for in recent months: to make the pipeline bypass China and terminate in Nakhodka, the nearest Russian port to Japan.

Japan's scheme would cost more than twice as much as China's, but it could deliver around twice as much oil (1m barrels per day) and give Russia access to a wide range of markets. The scheme is also seen as a potential boost to the development of the Russian far east. China's proposal would provide quicker returns: the pipeline would be operational by 2005, three to five years earlier than the Nakhodka route. But by using the Chinese route Russia would be gambling on a single market. And Japan is wary of dependency on China.

Both China and Japan have suggested that branch lines could be attached to their proposed pipelines to satisfy the needs of each country, providing that Russia had enough oil to service them. But whichever country gets the main deal will put its own needs first.

China's official media have made it clear how piqued China would be if Japan's bid wins or if Russia abandons the idea altogether. A scholar in Beijing, Ji Zhiye, has been quoted as saying that Russia's decision would affect the prestige of its leaders as well as China's relations with Russia. If the Russians decide in favour of Japan, that really would undermine Russian-Chinese friendship, says Philip Andrews-Speed, an energy expert at Britain's Dundee University.

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Afghanistan

Where opium is half of GDP

Sep 25th 2003 | KABUL
From The Economist print edition

Donors open their wallets a little bit wider

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THE gathering of donors to Afghanistan in Dubai last week was a melancholy affair. A few successes were tentatively noted. The Afghan government is extending its reach, said the American delegation—yet gory evidence in the south of the country points to the contrary. Afghan officials said invisible mechanisms had been set up, particularly for the disbursement of money to ministries, which would yield tangible results in the near future.

That was about it. The IMF tempered good news of economic growth—a whopping 30% last year, and maybe 20% this year—with a warning on drugs. Its bean-counters believe that the export of opium and its derivatives, which yielded about $2.5 billion last year, now accounts for half of Afghanistan's GDP. Production is fast recovering to its 1999 record level. Without a major intervention, it said, the country will slide into being a “narco-state where all legitimate institutions become penetrated by the power and wealth of drug traffickers.” Just so, agreed the Afghan finance minister, Ashraf Ghani. Several ministries are already approaching “narco-mafia” status, he volunteered. The World Bank was scarcely more upbeat. Life expectancy in Afghanistan still hovers around 40, it noted.

There was at least determined talk, and money to back it up. The head of the World Bank, James Wolfensohn, gave a pep talk. His organisation will spend $300m in Afghanistan next year on reconstruction and micro-financing. The bulk of the money will come from America, European Union members, Japan and Canada. The American contingent left in good spirits. By their own account, they managed to get other donors to match Washington's boosted funding for Afghanistan next year. Half of the $1.2 billion America plans to dole out will go on building up the national police and army. The rest will be spent on reconstruction and improving ministries.

Americans and others may also make use of an existing scheme which funnels money in the form of block grants to villages where, at least, funds get stolen at the micro level. Mr Ghani sang a depressingly familiar tune: spend now or pay later. All donations have been gratefully received, went his chorus, but how about some more. He reckons his country needs $30 billion over the next five years to make a go of it. He will be lucky to get half that.

A good chunk of the money promised over 15 months—$1.8 billion out of $2.1 billion—actually materialised. Yet, that amounts to an annual $67 per Afghan, which pales in comparison with what was spent on each Timorese and Bosnian following their civil wars. Afghans wonder why they get so much less.

Hovering on the fringe was Russia, which claims to be owed money by Afghanistan. Russian diplomats say Kabul is in hock to them for close to $10 billion—by what calculation is unclear. They say Russia would be ready to settle, in deference to hard times, for 20 cents on the dollar. No chance, splutter other diplomats. But Russia does not really expect to be paid. The issue is one of leverage. By forgiving Soviet-era debt, it hopes to win favourable agreements on mining, oil exploration and the import of machinery.

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India

Ayodhya's shadow

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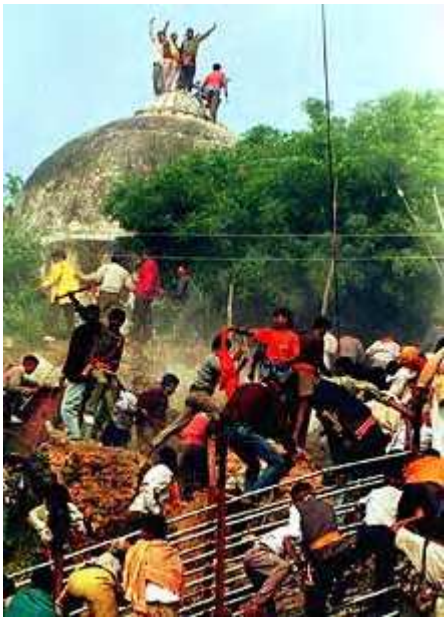
A riot 11 years ago still roils Indian politics

Get article background

THE Babri mosque in Ayodhya in the north-Indian state of Uttar Pradesh is no more, but it still casts a long shadow. It was demolished by a mob of Hindu fanatics in 1992 because they believed it trespassed on the birthplace of the divine king Ram. Ever since, whenever India has been scarred by large-scale communal violence, it has often been traced back to the wound left by that episode, and its unfinished business: the glorious new Ram temple devotees want to build on the site. The issue may also still fuel a power struggle among the leaders of India's ruling Bharatiya Janata Party (BJP), and the "family" of Hindu-nationalist organisations to which it belongs.

On October 10th, seven of those leaders will be formally charged for their alleged parts in the 1992 riot. They include Murli Manohar Joshi, the minister for human-resource development, and Uma Bharti, the BJP's candidate for chief minister in the important state of Madhya Pradesh, where elections are due to be held in November. But they exclude the man most associated with the mass campaign that culminated in the dismantling of the mosque: L.K. Advani, now India's deputy prime minister.



The Babri mosque's last moments

Mr Advani was also facing charges from the Central Bureau of Investigation. But the CBI's case against him was curiously flawed and, on September 19th, a court in Uttar Pradesh dismissed it. This saved Mr Advani from having to make an embarrassing choice. On the eve of the court's announcement, Mr Joshi had said he would resign his ministerial job if formally charged. This put pressure on Mr Advani to do likewise, or to reveal himself as less of a true follower of the BJP's "*hindutva*" ("Hindu-ness") ideology than Mr Joshi himself.

The dropping of charges both saves Mr Advani from this predicament and boosts his presumed ambitions to succeed Atal Behari Vajpayee as India's prime minister. The BJP rules in coalition with a score of smaller parties, many of which would have found it hard to accept a prime minister facing legal action for fomenting communal hatred.

Mr Joshi, however, has not given up playing to the hardline Hindu-nationalist gallery. As a minister, he burnished his *hindutva* credentials by overseeing the rewriting of school history textbooks to bring them more into line with the ideology's orthodoxy. Now he has carried through his threat to resign against the wishes of the BJP, which maintains the Ayodhya charges are all political. The BJP's spokesman, Mukhtar Abbas Naqvi, insists that Mr Joshi, "a very disciplined soldier of the party", will change his mind.

Even if he does, the unbuilt Ram temple will loom large in Indian politics ahead of a general election due before November next year. Mr Naqvi claims it will not be part of the BJP's campaign. But the party's parent, a mass organisation called the Rashtriya Swayamsevak Sangh (RSS), or Association of National Volunteers, has other ideas. Its spokesman, Ram Madhav, says that there are only three possible solutions to the temple dispute. Of these, the first—compromise between Hindus and Muslims—seems distant. The second, a court-imposed judicial solution, is equally remote. A dispute over ownership of the temple land has been dragging on for decades. That leaves legislation. The RSS says it will create a climate where campaigning BJP politicians have no option but to take a stand, and back the passage of a

law mandating the construction of a temple.

Climate-creation starts in earnest on October 15th, when another RSS offshoot is holding rallies in Delhi and Lucknow, capital of Uttar Pradesh. Mr Madhav expects 1m people to turn up and to move on to Ayodhya for a peaceful demonstration. “People needn't worry,” he chuckles. “There is nothing to demolish.”

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Australia and Papua New Guinea

Big brother?

Sep 25th 2003 | SYDNEY
From The Economist print edition

Tied aid upsets a neighbour

Get article background

ALEXANDER DOWNER, Australia's foreign minister, has a habit of talking down to his country's neighbours. Of Papua New Guinea (PNG), a former colony, which still depends on Australian aid for one-fifth of its budget, he said recently that it was “very lucky” to have this money. Mr Downer was responding to PNG's protests over Australia's plan to tie its aid, worth A$330m ($224m) a year, to stiff conditions. Australia wants to send a force of at least 200 police to tackle crime in PNG, and a posse of civil servants to sort out corruption and inefficiencies in the country's bureaucracy. If PNG rejected the proposal, he hinted, it might have to get by with less aid.

At first Sir Michael Somare, PNG's prime minister, accused Australia of wanting to take control of its old colony again and threatened to look elsewhere for his aid. After talks on September 18th between Sir Michael and Mr Downer in Port Moresby, the capital, PNG appeared to accept Australia's plan, subject to details being worked out by December.

Mr Downer called the plan “heightened Australian engagement” in PNG; but it also raised questions about Australia's wider strategic intentions in the Pacific. Two months ago, Australia led a force of more than 2,000 soldiers to restore order to the Solomon Islands, racked by civil conflict. The problems of both Pacific island countries stem partly from their rocky transitions to Westminster-style government after independence, PNG from Australia in 1975 and the Solomons from Britain three years later. In PNG's scattered provinces, loyalties are often more tribal than to parliament in far-away Port Moresby. Corruption has flourished. Money for hospitals and schools has disappeared. Foreigners live behind barbed wire in the crime-ridden capital.

Australia's conservative coalition government, led by John Howard, argues that intervention in the affairs of so-called failed states in Australia's neighbourhood is justified to stop them turning into havens for international crime and terrorism. Although life in PNG has not broken down to the same extent as in the Solomons, Australia says it is now time to get tough before it does. And, however unlikely it may appear that terrorists would choose island states such as the Solomons or PNG to launch attacks on Australia, the argument seems to have public approval at home.

Australia has been floating the idea of a Pacific economic and political community with a common

currency based on the Australian dollar. But the PNG intervention is likely to strengthen feelings among island nations about loss of sovereignty. An Australian parliamentary inquiry into relations with the Pacific reported in August a sense of disapproval in the region towards Australia's “big brother” approach. Offering a helping hand is one thing; creating a climate of goodwill is another.

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About sponsorship

Indonesia

Not the easiest way of making money

Sep 25th 2003 | JAKARTA
From The Economist print edition

Attracting investors back to Indonesia is an uphill struggle

WITH its terrorists, separatists and political tumult, Indonesia might not seem like the ideal place to invest. Nonetheless, in late September, various economic ministers, and even the normally aloof president, Megawati Sukarnoputri, fanned out around the world in order to entice international capital to the land of the Bali and Marriott bombings. Their pitch is a simple one: despite such disconcerting events, Indonesia is a good place to do business.

By certain measures, the pitch is right. As Dorodjatun Kuntjoro-Jakti, the minister with overall responsibility for the economy, points out, after six years of chaos, Indonesia's economy has finally stabilised. The rupiah has appreciated from a low of 17,000 to the dollar to a steady 8,500. The budget deficit has shrunk from 4.8% of GDP to 1.8%, and government debt from 100% to 67%. Inflation, which peaked at 60% in 1998, is down to 6% and still falling. Buoyed by this parade of encouraging figures, the stockmarket has recently hit several successive three-year highs.

But that is only half the story. First, the government adopted many of the policies behind this exemplary performance only at the insistence of its sternest creditor, the International Monetary Fund. Yet Indonesia's IMF programme will close at the end of the year, and the government has pointedly declined to renew it.

Second, Indonesia's macroeconomics might have stabilised, but its politics have not. A fully-fledged war grinds on in Aceh province; soldiers and indigenous activists are squaring off in Papua, and Muslim terrorists operate nationwide. Next year Indonesia will hold three national elections (one parliamentary one, and a two-round presidential poll). As if these distractions were not enough, Indonesian businesses are afflicted by a muddled legal system, multiple layers of corrupt bureaucrats, poor infrastructure, and restrictive labour laws. Little wonder that foreign investors have been pulling their money out of the country since the Asian crisis of 1997.

With the recent improvement in the economic picture, this capital flight has slowed, and money is flowing back into the stockmarket. But few investors, foreign or Indonesian, are willing to make long-term bets on Indonesia's prospects. Overall investment is stagnating at around half the pre-crisis rate. The government is aware of investors' misgivings, and is trying to allay them. Officials hint that they did not want to part company with the IMF, and the cheap loans it provided, but were forced to by Indonesia's obstreperous parliament. To hammer the point home, in mid-September, Mr Dorodjatun unveiled a white paper detailing the government's plans for economic reform, as a substitute for the letters of intent it used to provide the IMF.

The measures in the paper—a new investment law, accelerated privatisation, legal reform, counter-corruption measures and so on—look sensible enough, says Fauzi Ichsan, an economist at Standard Chartered Bank. But he is not sure that the government, freed from the constant cajoling of the IMF, will actually implement them. Ominously, it released the white paper itself a month behind schedule. Parliament, which must approve almost all the prescribed policies, is slower still. When the minister in charge of privatisation berated the relevant parliamentary committee for dithering, it responded by postponing further hearings on the subject indefinitely.

The politicking surrounding next year's elections will slow things down yet further. But speed is not the

only issue. Sharp-eyed critics noted that despite the many corruption-busting schemes in the white paper, the government has dropped the one concrete step the IMF had called for in that regard: the prosecution of recalcitrant debtors of the state-owned asset-management company, IBRA.

Meanwhile, the courts continue to issue bizarre rulings. In the latest example, one upheld a developer's refusal to repay loans used to construct two high-rise office buildings in Jakarta. Venal local governments are also driving off investors. When local officials began breathing down their necks, the owners of Indonesia's biggest coal mine suddenly agreed to sell it at a discount of almost 40%. This culture of legal confusion and corruption is by far the biggest obstacle to investment. And most Indonesians seem to consider politicians the source of the problem, not the solution.

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America, Iraq and the UN

To rescue Iraq, it's time to move on

Sep 25th 2003
From The Economist print edition

The UN Security Council needs to find better ways to handle threats to peace. Not easy, at all

A YEAR ago, President George Bush challenged the United Nations to live up to its principles, and its own resolutions, by dealing with Iraq's defiance, or become “irrelevant”. When America and its coalition allies went on to fight—and speedily win—the war to topple Saddam Hussein's regime without explicit backing from a divided Security Council, both friends and critics worried that the Bush administration might now turn its back on the UN altogether. Since then, steadily mounting American casualties and the costs of post-war Iraq have caused Mr Bush's approval rating at home to slip. So this week brought the president back to the UN in search of a new resolution to encourage more countries to lend troops and to donate funds. A lesson in humility for the world's most powerful country?

Not a bit of it. But if Mr Bush had no apologies to make for his actions in Iraq—history, he insisted, would judge them to have been right—nor did his chief critic, France's Jacques Chirac. Both men would agree with Kofi Annan, the UN's secretary-general, that the row over Iraq now presents the UN with choices as momentous as any since its founding in 1945—not just about the future of Iraq itself, but the way the Security Council will handle other threats to security. Will past divisions now undermine efforts to bolster peace in Iraq and beyond?

The talk at the UN's General Assembly meeting this week was of moving on. Mr Chirac had previously signalled that he would not block America's bid to win a mandate for its military operation to stabilise Iraq—as it had the effort to get approval for the war. Having earlier insisted that sovereignty be handed over to Iraq's Governing Council within a month, Mr Chirac now talks merely of a “realistic” timetable, suggesting there is room for political compromise too. Mr Bush, for his part, promises a bigger role for the UN in Iraq, though still only an advisory one, alongside America's own administrator. And he is adamant that power and sovereignty be handed over to Iraqis in an “orderly” fashion—that is, after a constitution has been adopted and a government democratically elected.

Yet there still seems little enthusiasm from many governments for deeper involvement in Iraq. A donors' conference next month in Madrid looks like raising between $1 billion and $2 billion at most—a drop in Iraq's bucket of need. That may be one reason why Iraq's interim government this week set out to woo private investors (see article). But neither aid nor investment will flow easily without security.

Mr Bush's officials have recently been talking down the possibility of tapping large numbers of extra

foreign troops, although Russia, which like France opposed the war, has nonetheless hinted it might offer some. Instead the Americans want to hand over more security duties, as quickly as training allows, to Iraq's own nascent army and police force. Training elements of such a force is something both Germany, another critic of the war, and France have suggested they might yet do.

One way or another, the countries that fell out so badly over the war are looking for ways to work together, even if they cannot overcome all their differences. But what of the UN's role in dealing with future security threats?

Mr Chirac was fiercely critical of America's resort to unilateralism; Mr Annan was scarcely less so (though of scores of wars fought since the UN was founded, the Security Council has authorised only two). But Mr Annan also pointed out that, unless the council itself was prepared to deal with the most difficult threats, from genocide to the spread of weapons of mass destruction, those who feel threatened will continue taking action themselves.

What can be done? Mr Annan is to assemble an eminent-persons group to look, among other things, at the case for collective action, even pre-emption, to deal with such threats. Mr Chirac suggested convening a Security Council summit on proliferation. And Mr Bush proposed a new Security Council resolution to criminalise the spread of weapons of mass destruction. That would make it easier for many governments to support efforts by 11 countries, including America and France, to disrupt the trade in such weapons and the materials and technologies to make them.

Will all this make the next big challenge easier to handle? Not necessarily. As the row over Iraq showed, agreeing what constitutes a threat, and then agreeing how to deal with it, can be very different.

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Iraq's economic liberalisation

Let's all go to the yard sale

Sep 25th 2003
From The Economist print edition

If it all works out, Iraq will be a capitalist's dream

Get article background

A SHOCK programme of economic reforms signals a radical departure for Iraq. The changes, announced by the country's provisional rulers at the annual World Bank/IMF jamboree in Dubai, could see its battered economy transformed abruptly into a virtual free-trade zone.

If carried through, the measures will represent the kind of wish-list that foreign investors and donor agencies dream of for developing markets. Investors in any field, except for all-important oil production and refining, would be allowed 100% ownership of Iraqi assets, full repatriation of profits, and equal legal standing with local firms. Foreign banks would be welcome to set up shop immediately, or buy into Iraqi ventures. Income and corporate taxes would be capped at 15%. Tariffs would be slashed to a universal 5% rate, with none imposed on food, drugs, books and other “humanitarian” imports.

The reforms follow other bright economic news. The Bush administration is proposing to sink a whopping $20 billion into Iraqi reconstruction over the coming year, a sum roughly equal to two-thirds of Iraq's current GDP, or to one-third of the $60 billion-70 billion total that current estimates say will be needed to repair the country in the medium term.

A new currency is to be launched towards the end of October, shortly before a donor conference in Madrid that is likely to solicit huge sums more in international aid. Other initiatives have already created an independent central bank, as well as a trade bank backed by a consortium of 13 foreign banks and a $500m credit from America's ExIm Bank. Together, the moves hold the promise of yanking Iraq back into the global economy in record time.

Yet several ifs loom large. Rampant insecurity is likely to deter all but the most avid investors for months to come. Even if a gush of development funds is released, aid pipelines, and America's in particular, are notoriously long and twisted. Questions also linger over the durability of the new commercial rules.

Naysayers question the motives and authority of a government that is still widely seen as an American puppet. The regulations were announced by Iraq's nominal finance minister, Kamel al-Gailani, but they bear the signature of Paul Bremer, who heads the American-run Coalition Provisional Authority, and the imprimatur of the American consultants it has hired to frame economic policies.

The rules also bear an important caveat. They are subject to “adoption or replacement” by a future, elected Iraqi government. Given the shock and awe expressed by many Baghdad businessmen at the scale of the changes, it is not clear that such a future regime would be able to resist pressures to reimpose protectionism.

Fears of invasion by multinationals keen to wipe out local competition are doubtless exaggerated: Iraq urgently needs outside investment and expertise. Even so, the instant discarding of 40 years of national-socialist commercial culture is likely to create serious distortions.

The changes will, however, cheer another important constituency, the American Congress. Mr Bremer, testifying before American legislators to justify the demand for huge new outlays, cited the reforms as proof that Iraq is beginning to follow the American way. The unspoken wish is that this will create a poster-child for the recalcitrant economies surrounding it.

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Iraq's constitutional troubles

Cursed by crime and numbers

Sep 25th 2003 | BAGHDAD
From The Economist print edition

Sectarianism is making planning a constitution that much harder

AFP

Seeing through a glass, darkly

Get article background

“GO AWAY,” bawled a rabble of men, rattling sabres and cudgels at an Iraqi delegation sent to the southern city of Hilla for talks on how to draw up the country's constitution. “We have nothing left to discuss.” This summer, Grand Ayatollah Ali al-Sistani issued a *fatwa* declaring that only an elected assembly has the legitimacy to draw up a constitution. And that, for many of Iraq's 15m Shias, is that.

Yet the times could hardly seem less conducive to compiling a voter list, let alone an election campaign. Attacks on the American troops and their Iraqi partners are running at around 30 a day. In the past week alone, the Iraqi resistance assassinated Aqila al-Hashimi, a member of the Governing Council, launched a second bomb attack on the UN's Baghdad headquarters, killed two people in a cinema in Mosul, and much else besides. Protesters in Faluja, a troubled town west of Baghdad, demonstrated in support of the former regime. Even in southern Iraq, loyalists paint the walls with “Long Live Saddam” faster than others can erase it.

An alarming report from the UN claimed this week that “foreigner Taliban” fighters had intruded over Iraq's north-east border with Iran, and had even penetrated Baghdad. Where once Baghdadis feared car-jackings and kidnappings, they must now fear improvised bombs.

But what really worries Iraq's Preparatory Constitutional Committee about elections is not the violence but the numbers. The security problems should be surmountable; the demography is not. Should Iraq's Shias, who form a majority of the population, unite, they would swamp the polls, shunting aside Sunni Arabs, the country's plethora of other minorities, and the Kurds who look to a federal Iraq to protect their interests. Elected mullahs might be expected to draw up a constitution modelled less on America's than on Iran's Islamic Republic.

To narrow the gap between the Shias and the rest, the constitutional committee last week paid a call on Mr Sistani, the spiritual mentor of many Shias. He argued, diplomatically, that only elections could safeguard the constitution from American interference. This convinced even a Kurdish representative on the committee, to the chagrin of Kurdish leaders who fear that an electoral process might crush their dreams of a federal state, and would slow down the transfer of sovereignty.

Arab Sunni resistance to Shia *force majeure* is fierce. Since the fall of Baghdad, Shias have obtained a majority on the Governing Council and in many ministries. This month, they seemed poised to overrun the Ministry of Religious Affairs, which is probably Iraq's second-richest ministry (oil is already in Shia hands). Its huge network includes Sunni (but not Shia) religious trusts, or *Awqaf*, which after 1,400 years of Islamic bequests number 10,000 properties in Baghdad alone.

In an attempt to defuse the battle for the *Awqaf*, Iraq's American administrator, Paul Bremer, dissolved the Ministry of Religious Affairs with the ruthlessness of Henry VIII. But he still managed to infuriate Sunni Islamists by putting a Shia official in charge pending abolition, and he left unanswered the question of what to do with the *Awqaf*'s fantastic resources.

Sunni preachers accused the Americans, and their Shia proxies, of plotting to rob Sunni Islam of its real estate. They also lambasted the Shias for filching 18 Sunni mosques, including two in the Shia holy cities of Karbala and Najaf, as part, they say, of a programme of sectarian cleansing. Vowing to defend their ancestral lands, some preachers are calling for a defensive *jihad*. They accuse the Shias of betraying their faith and Iraq by collaborating with a non-Muslim invader of Muslim land.

“The Americans should be forced out the same way they came in,” thunders Abdelsalam Kubaisi, an Islamist in the Baghdad Sunni heartland of Al Athamiya. His list of justified acts ranges from daubing anti-American slogans on the walls to planting bombs under bridges. “It's an individual decision,” he declares.

Sectarian splits

To ease the looming sectarian tensions, the Governing Council has proposed splitting the religious ministry's remaining functions into three separate directorates for Sunnis, Shias and others (Christians, Sabeans, Yazidis, and 34 Jews). “There is no other way to prevent sectarian disputes over land,” said Nasir Chaderji, one of the council's five Sunni Arab members. But while the measure was welcomed by Sunni Islamists, reassured that they would then hold on to their trusts, the precedent of awarding civil-service posts according to sect dismays all those who want Iraq to retain its religious unity.

Would elections help to heal the divisions? The constitutional committee remains divided, with some members arguing that campaigning would extend the Islamists' platform from the mosque to the street. The committee has already overshot its deadline of September 15th for submitting its proposal for the constitutional process. And while it has used its two-week extension to sound out opinions elsewhere in Iraq, it has shied away from visiting the rebellious Sunni triangle north and west of Baghdad. Delegates fear that a proposed ban on Baathists joining the constitutional assembly might encourage the use of weapons more dangerous than cudgels.

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AIDS in Africa

Slowly, the virus is being fought

Sep 25th 2003 | JOHANNESBURG
From The Economist print edition

More money, drugs and willpower, but a long way to go

Get article background

IF TALK could cure AIDS, the disease would long be beaten. This week saw two big talking shops: a special session of the UN General Assembly in New York, and a meeting in Nairobi of African health ministers and others. The message from both was the same. The best way to prevent people from catching AIDS is education and testing; the best way to keep those who have already got it alive is administering anti-retroviral drugs.

Delegates in New York were told that 42m people are now infected with HIV, three-quarters of them in Africa. The plague has already killed 15m Africans, twice the population of London. Women and girls are particularly vulnerable: nearly 60% of infected Africans are female. In parts of southern Africa, two in five adults are now infected. In Zimbabwe, where economic collapse and the disease stalk hand-in-hand, Unicef's representative, Festo Kavishe, speaks of “bodies piling up in the mortuaries” and of 700,000 children now orphaned by AIDS.

But the tale from the continent is not uniformly dismal. Senegal, Botswana and one or two other countries offer anti-retroviral drugs at public hospitals. In South Africa, which has over 5m HIV-infected people, a long-reluctant government has at last said it is persuaded to give out drugs at public clinics, though it has not said how or when. And last month a South African company got a licence to start making generic copies of anti-AIDS drugs.

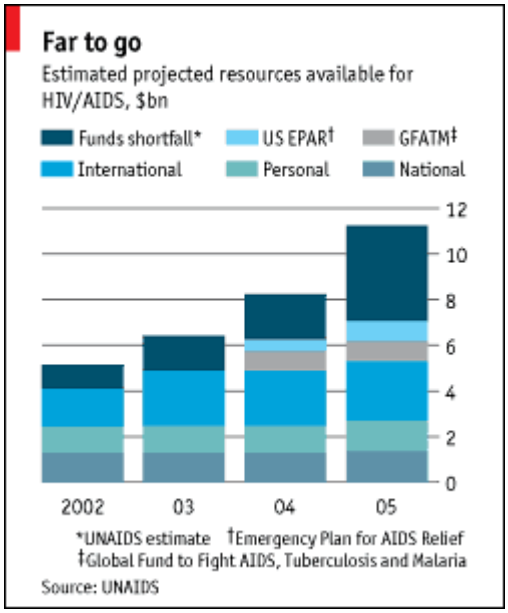
Drug companies report that 76,000 Africans now take the pills. This is double last year's total, though it is still less than 2% of all the people who need them. Studies show that patients stick carefully to their drug regimens, scotching the idea that African pill-takers would not be able to keep to the careful routines.

Stephen Lewis, the UN's special envoy on AIDS, points out that many African presidents have become closely involved in fighting the disease. This contrasts with eastern Europe and Asia, two areas that face the epidemic but where the top politicians tend to leave the battle to their health ministers. Moreover, most African countries now have a national anti-AIDS strategy; a few, such as Kenya, call the plague a national emergency.

The UN says that $4.7 billion is now being spent on the disease in poor countries, 20% more than last year. As governments grow more receptive, donors and UN agencies are helping a bit more: Mr Lewis, in Kenya, called the world's neglect “obscene”. This week Jong Wook-Lee, the new boss of the World Health Organisation—which at present spends only 5% of its $1 billion annual budget on AIDS—proposed the goal of 3m people getting anti-retroviral drugs within two years, tenfold more than the 300,000 in poor countries now. The plan will be launched in December, with emphasis on Africa. The Global Fund to Fight AIDS, Tuberculosis and Malaria also announced this week that it plans to pay for drugs for hundreds of thousands of extra people in the coming years.

If pockets had been opened earlier, millions of lives would have been saved, lamented Peter Piot of UNAIDS this week. Yet better

late than never. South Africa and other southern African countries are now entering the “death phase” of the epidemic, as more patients die than there are new infections. The provision of drugs would slow down the dying, give people much more reason than they now have to get themselves tested, and save countless children from being orphaned.



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Islamic law in Nigeria

Shilly-shallying with sharia

Sep 25th 2003 | GUSAU
From The Economist print edition

The new penal code based on the Koran has not had much impact on daily lives

Get article background

AP

But she shouldn't have been threatened

THE story of a Nigerian woman sentenced to be pelted to death with stones for having a baby out of wedlock ended decently on September 25th when Amina Lawal was cleared on a technicality by a panel of Muslim judges. She had been sentenced to death 18 months earlier under a new Islamic legal system. The case shocked the world because of the hideousness of the punishment prescribed by Islamic law for extra-marital sex. But few in Nigeria believed that Ms Lawal would really meet such a dreadful fate.

Four years ago, Muslims in northern Nigeria rejoiced when their politicians vowed to implement existing Islamic legislation, or *sharia*, more forcefully, extending it to the penal code of the 12, mostly Muslim, northern states. Criminals would be dealt with harshly: *sharia* punishments include amputation for theft, stoning for illicit sex, even crucifixion, when murder is committed and property is seized.

Northerners were tired of rising crime and rampant corruption in public office. Many Muslims believed that the implementation of religious law would bring greedy officials to book, curb violent crime and clean up what they saw as a morally decadent society. It also created thousands of jobs: Islamic vigilantes, and *sharia* preachers and judges are on state payrolls.

Enthusiasm for the religious code has waned. At first, state governors enforced the law. In 2000, two petty thieves in the state of Zamfara, and one in Sokoto, had their hands surgically removed under anaesthetic by the governor of Zamfara's own physician. Their respective crimes: stealing a goat, a cow and nine bicycles.

But, since then, governors have stopped authorising such grisly punishments. Dozens of amputation sentences have not been carried out. Nor has anyone been stoned to death, though seven have been sentenced (three were cleared on appeal, two are on appeal, one is on death row, and the last has just been sentenced).

Has *sharia* gone soft? Governors say it has not, but claim that they need time to review sentences with a council of Islamic scholars before they confirm capital punishments. But hardline Islamic leaders complain. They believe that the governors introduced Islamic law to win votes, not from religious conviction. Now that most of them have been re-elected for a second (and last) term in April, they are back-tracking, and not seriously seeking to enforce compliance with the code.

In Zamfara, the first state to extend *sharia* to its penal code, veiled women ride on the back of motorcycle taxis driven by men, even though the law forbids it. Taxis, once painted “women only”, carry men and women, so long as men sit in the front seats and women in the back. In Gusau, Zamfara's capital, most cinemas have been converted into Islamic preaching centres, but salacious Nigerian home videos are still on sale in roadside stores.

Beer parlours and brothels in Gusau have been shut down but Muslims can drink and meet prostitutes with impunity at the local army barracks, known as the mammy market because soldiers' wives brew

moonshine and sell beer. Elsewhere, if Muslims are caught drinking, they are publicly flogged. But the caning is meant to humiliate not injure. Outside a *sharia* court, in front of schoolchildren and bystanders, two young men smile nervously after a court official lightly smacks their backsides with a goat-skin whip.

The police in Zamfara claim that Islamic law has reduced both crime and corruption. Civilians are not so sure. The fear of amputation may have deterred small-time criminals, but heavily armed robbers continue to ply the highways, and policemen manning checkpoints continue to extort money from motorists. A handful of civil servants have been punished under *sharia* for minor offences, such as throwing rowdy parties, and sometimes for serious ones, like embezzling public money for personal use (oddly, pocketing public funds does not constitute theft but is considered a breach of trust, and carries a jail sentence, not amputation). But there have been no high-profile convictions. It is mostly the poor and the weak, like unfortunate Ms Lawal, who get caught.

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Mauritius changes government

Offshore and upbeat

Sep 25th 2003 | PORT LOUIS
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Picture postcards tell the truth about the place, more or less

A HAPPY game of musical chairs is due to begin on September 30th. Shortly after lunch, Sir Anerood Jugnauth, the prime minister of Mauritius, will resign, to be replaced within hours by his deputy, Paul Bérenger. A few days later, Sir Anerood takes up the largely ceremonial job of president. It is a measure of the stability of this Indian Ocean island, far off Africa's east coast, that all this has been in the offing since an election in 2000. The party leaders struck a power-sharing deal, and stuck to it. This, says the prime minister-to-be, shows that “Mauritius is in great health with a real, lively democracy.”

Complicating matters, Mr Bérenger has a white skin, and traces his family roots to Marseilles in France. In most of Africa (Mauritius is a member of the African Union), the return of a white leader to power would be unlikely if not impossible. In Mauritius, there were no more than a few grumbles from the majority Indian group that, until now, has produced every prime minister since independence in 1968.

Some of the most resentful grumbles have come from Mouvement Républicain, a left-wing opposition party which is suggesting that Mr Bérenger's two-year rule, until the next election, will threaten national unity. It argues that the whites, who constitute just 2% of the 1.2m islanders, do not deserve political power because they already have too much of the economic sort, especially in tourism.

Mr Bérenger agrees that there are tensions between the different ethnic groups from Africa, India, China and Europe; and says that “under the surface of the nice postcard, Mauritius is still fragile.” Pretty deep under the surface, one might add: when asked about violence, people speak of an incident in 1999 when the police shot two rioters after a singer died in jail.

In 1982, Mauritius became the first African country to vote an opposition party successfully into office. Rival politicians usually agree on the policies that matter: Mr Bérenger has long dropped his once-socialist leanings. Co-operation between parties, especially on economic matters, reassures investors and has made Mauritians far richer than most African countries. Some 18,000 offshore financial companies are listed on the island; foreign tourists flock to its beaches; and investors are building a $100m high-tech “cyber city” for telecom and computer companies. An enviable model, indeed.

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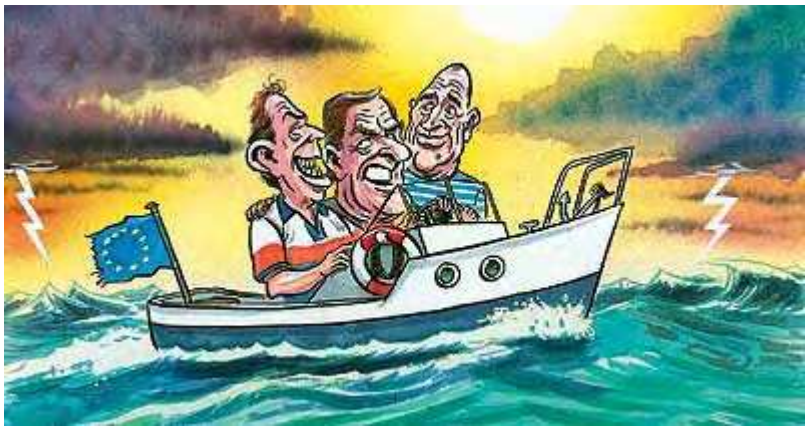
The European Union and NATO

A lull between the storms

Sep 25th 2003
From The Economist print edition



Was it a real agreement on Europe's future defence or just an effort to be polite?

WHEN European leaders get together, a turn of phrase or subtle change of emphasis can convey their thinking on the future shape of the Union. When the subject is defence, such nuances can also intimate their attitudes to America and NATO, the alliance that is supposed to bind the two sides of the Atlantic together. But it is often difficult for the uninitiated to interpret these smoke-signals. It is especially tough if, as was the case after Britain's Tony Blair, France's Jacques Chirac and Germany's Gerhard Schröder met in Berlin on September 20th, the countries differ about what, if anything, was agreed.

The Germans said that the British had changed their minds; the British said they hadn't. The subject was whether the EU should have its own military planning facilities, separate from NATO. (The EU already has its own military staff, but it mainly does broad strategic, rather than operational, planning.) In April, Messrs Chirac and Schröder, along with their counterparts from Belgium and Luxembourg, controversially proposed that such an HQ should be established at Tervuren, a suburb of Brussels—an idea regarded in London and Washington as a small but symbolic step towards the rupturing of NATO. “Tervuren is a symbol of competition” between the EU and NATO, says Nick Burns, America's ambassador to the alliance. This fear—that the Europeans might one day go it alone—explains why some Americans have mixed feelings about the EU's defence effort, even though it could ease America's global burdens.

In principle, Britain is keen on European co-operation in defence: it is one area where Mr Blair really can be in the EU's vanguard. And the idea of some independent planning capability is not in itself anathema: the French-led EU operation in Congo was planned using French facilities. But the British have insisted that the EU should avoid duplicating NATO assets in any way that might undermine the alliance. So, for instance, the EU's embryonic rapid-reaction force and NATO's nascent force are designed to do different jobs. (Africa is one area in which the EU may act alone; others may emerge on the Union's new borders after their shift eastward next year.) In this view, the Europeans don't need a new HQ, because under an agreement reached last year they can use NATO's facilities for bigger operations. They are already relying on NATO assets for their current mission in Macedonia.

The other, related topic on which Mr Blair seemed to have shifted is what, in the EU's elegant jargon, is called “structured co-operation”. This means that the EU's more militarily advanced countries can choose to push ahead with defence co-operation without the others. Britain has hitherto sounded sceptical about that, too. But Mr Blair went along with Mr Schröder when he said that while it would be ideal for everyone to proceed together, if that wasn't possible, structured co-operation would be fine. It may be that Mr Blair has been persuaded that nothing very serious can happen, defence-wise, unless Britain is a part of it; and that this sort of mechanism will be necessary to get anything done after the EU's

enlargement.

In any case, Mr Schröder found a form of words, including friendly references to NATO, with which all three leaders could live—for the time being. The hair-splitting will begin at a meeting of defence ministers next week and continue during negotiations over the European constitution, which will lay out the architecture of European defence. Among the all-important details is the location of the putative new planning unit: the British want it to be physically based at NATO's main HQ, which would make it seem much less of a rival than the Tervuren idea. How easy it should be for countries to join in with the structured co-operators, and how accountable they should be to the rest of the Union, must be thrashed out too. There may also be a row over whether the EU should have its own guarantee covering territorial defence. The British say that is NATO's job.

The truce

Berlin was an opportunity for the three leaders to show some goodwill in advance of the thrashing. The other context of their conciliatory meeting, was, of course, the lingering rancour over Iraq.

That rancour is part of the inheritance that awaits Jaap de Hoop Scheffer, the Dutch foreign minister who will take over as secretary-general of NATO when Lord Robertson, a dogged Scot and the alliance's current chief, steps down at the end of this year. Having seen NATO snubbed by America after September 11th, Lord Robertson made a good fist of defining a role for it in the post-cold war world. NATO is also expanding eastwards, and it recently took over command of the security operation in Kabul, its first “out-of-area” task.

But the internal wrangle over Iraq was, Mr Burns said at the time, “a near-death experience” for the alliance. (NATO is now giving logistical aid to the Polish peacekeeping effort in Iraq, but sending in NATO troops while America, one of its members, retains command, would be tricky.)

Mr Scheffer is known as a good deal-maker. He and his country wobbled over the war without alienating their neighbours. He will need those skills to subdue the mutual suspicions among NATO's member countries: on one side are the Atlanticists who fear that the French camp wants the EU to usurp the alliance; on the other are those who fear NATO may become simply an arm of American foreign policy. Just as importantly, Mr Scheffer will need to lean on his members to meet their promises to buy new and needed hardware, which can get forgotten amid all the posturing.

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Germany's foreign policy

Playing all sides

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Soft talk in Washington does not mark a retreat from independence

TALK about a delicate exercise in oratory. When Gerhard Schröder, Germany's chancellor, took the floor at the United Nations in New York on September 24th to mark the 30th anniversary of his country joining the organisation, he had two conflicting aims: first, to reaffirm Germany's commitment to multilateralism and the rule of law in world affairs; second, to do so without annoying the United States and President George Bush, with whom he had just had the first meeting of substance since the transatlantic crisis over Iraq began last year.

Repairing relations with Mr Bush will, however, take more than a speech and a meeting. Though in no way disavowing its renewed closeness to France, Germany is once again trying to play all sides and to present itself as a mediator—much as it did before the row over the war in Iraq. But does this mean that Germany is edging back towards its old unalloyed friendship with America? Mr Schröder's decision to side openly with France over Iraq was the first time since the second world war that a German government had decided so bluntly, in a major transatlantic issue, to oppose the Americans. Many thought that Germany's stand over Iraq, along with its apparently growing keenness for an independent European defence arm, marked a tectonic shift.

Many within Germany's foreign-policy establishment hope not. For sure, Germany plainly no longer depends on the Americans as it did before the Berlin wall came down. But if Germany's embrace of the anti-American French were to get still tighter, the country—argues Ulrike Guérot of the German Council on Foreign Relations in Berlin—would no longer be able to serve as the glue between Europe and the United States, between the western and eastern parts of Europe, and between large and small countries in the European Union. The rancour between Europeans over Iraq, she says, has demonstrated the risks of that approach.

Hence Germany's “swing back”, as Ms Guérot puts it. Nearly all foreign-policy pundits, including those in the foreign ministry, in the opposition and, most important, in the chancellor's office, are now singing the same tune. A European counterweight to the Americans? Forget it, even if Europeans had the military punch. A European defence capability? Yes, but not in opposition to NATO (see article). A different policy on Iraq? No, not now: let's stop the blame game and work together to make Iraq more peaceful.

But it will not be easy to win back American favour. Joschka Fischer, Germany's foreign minister, remains adamant that no German soldier will be sent to Iraq. Nor have the cash-strapped Germans offered much towards rebuilding the place. But they have offered to train Iraqi policemen and soldiers. And the Germans have said they are willing to send more troops to Afghanistan, where, under NATO command, they have the largest contingent.

Does this add up to a return to German “predictability”, as Atlanticists have hoped? Not yet. A debate about Germany's national interest, long avoided because of the historical baggage of German guilt, is under way. People are asking whether it is really to Germany's advantage to deploy soldiers in the more dangerous parts of Afghanistan, or indeed in Iraq. Good European that he is, Mr Fischer sticks to the old post-world-war doctrine that, for Germany, the European interest and the national interest are the same thing. But a growing number are taking a more robustly self-interested view.

Even if the foreign-policy establishment wants to get back into America's favour, the public is less sure. Pollsters say that only 45% now think that strong American leadership in world affairs is desirable, against 68% a year ago. By contrast, the number of those who want the EU to become a superpower has risen from 48% to 70%, though a large majority still thinks that Europe should co-operate rather than compete with the United States.

As a result, politicians and pundits, even on the right, are much warier of sounding pro-American. For instance, after Mr Bush's speech on Iraq earlier this month, that bastion of Atlanticism, the *Frankfurter Allgemeine Zeitung*, called his demands for international help “unreasonable”. These days one of Germany's favourite American authors is Michael Moore, a virulently anti-Bush icon of the American left. His books “Stupid White Men” and “Downsize this! Random Threats from an Unarmed American” are topping Germany's bestseller charts, while his documentary film, “Bowling for Columbine”, is packing the cinemas.

Much depends on Mr Schröder. He has apparently decided to focus more on international affairs, perhaps because his foreign policy is a lot more popular than his plans for painful reform at home. On September 20th his Social Democrats were thrashed in Bavaria's state election, not even winning 20% of the vote against the conservative Christian Social Union's 60%-plus. Bavaria has long been a conservative stronghold, but this showing was the Social Democrats' worst ever.

Mr Schröder has always tended to pander to public opinion. But in foreign policy he may have become more his own man. As the first post-war chancellor to have been brought up after the war (in which his father was killed), he is less burdened by feelings of national guilt. Germany, he believes, now deserves to take its place as one of the world's leading countries, with its foreign policy made at home. Indeed, in his speech in New York on September 24th, he again asked, indirectly, for a permanent seat on the UN Security Council.

Indubitably, Mr Schröder wants to patch things up with the Americans. But relations with them, he reckons, should be more equal than in the past. Moreover, whoever is Germany's next chancellor will probably think the same.

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Russian-American relations

Warm and fuzzy

Sep 25th 2003 | ST PETERSBURG
From The Economist print edition

Russia and America are friends again, but of a rather passive sort

AP

Putin's broad horizon

WHEN journalists' mailboxes start filling up with policy papers about Russian-American relations, it is obviously presidential-summit time again. George Bush, write Michael McFaul and James Goldgeier, two American foreign-policy experts, “must be looking forward” to his meetings on September 26th-27th with Vladimir Putin, one of his few real remaining friends on the world stage. Since Mr Putin's alliance with France and Germany against the war in Iraq—which, Mr Bush seems to have accepted, was a reluctant one—their diplomats have worked furiously to patch things up. The two countries, writes Celeste Wallander of the Centre for Strategic and International Studies in Washington, “can be allies in the best traditions of far-sighted traditional great power diplomacy.” In Moscow, Sergei Karaganov, a foreign-affairs analyst close to the Kremlin, says the relationship could now reach unprecedented heights.

But heights of what? What Russia and America know how to deal with best, whether as opponents or allies, is global-security issues—reducing nuclear arsenals, preventing the spread of weapons of mass destruction, containing unstable or rogue regimes, fighting international terrorism. And on these the two presidents already agree more and more.

Russia, says Mr Karaganov, is beginning to worry, like America, about a nuclear-weapons programme in Iran (though it still wants to let Iran build nuclear-power stations), and to recognise the threats from instability in the Middle East, not so far from its border. America has placed some Chechen organisations on its list of terrorist groups. The two have overcome differences on nuclear-arms reduction treaties. The devil is in the detail of these issues, writes Mrs Wallander, and the warmth between the two presidents is often not shared by the diplomats, bureaucrats and military officers who have to make the partnership work.

Meanwhile, trade between the two countries is still tiny, just 1% of America's total and 5% of Russia's. Europe's economic ties with Russia are far bigger and will grow faster with the EU's imminent expansion; on this score Russia's foreign-policy people need to work harder: they are still better at geopolitical than economic negotiations. Even the most pro-European of Russian politicians, says a European diplomat in Moscow, have “a very low level of understanding of Europe; even those who want Russia to join the EU can't imagine accepting the *acquis* [of EU law] or submitting to EU decisions.”

Last week the Commonwealth of Independent States, the rump of the old Soviet Union comprising Russia, Ukraine, Belarus and Kazakhstan, said they would create a “common economic space”; but even if that ever became a reality, Russia's economic ties with Europe (and, one day, China) will remain more important.

Energy is a much-touted area where co-operation with America could grow. The Americans want energy sources other than the OPEC oil cartel, and Russia, the world's second-largest oil producer, would like to be one of them. Though it now supplies less than 3% of America's oil, that is rising. This week saw a star-studded summit in St Petersburg, with the American and Russian trade and energy ministers and oil bosses from both countries.

But while this Russian-American “energy dialogue” has produced plenty of ideas for speeding up the oil flow—mostly by increasing Russia's export capacity and improving investment conditions—real projects are, as yet, few. The big buzz of the summit was not even oil, but a scheme to liquefy natural gas on Russia's Pacific coast and pipe or ship it across to America—which, at best, will not happen before the end of the decade. In any case, says Igor Leshukov of St Petersburg's Institute for International Affairs, American speakers seemed vague by comparison with the detailed presentations of the Russians. With Iraq and its vast oil reserves not yet fully under control, they are waiting to see what their opportunities there will be before they commit themselves to Russia.

So what else can the two presidents discuss? At least one new issue may crop up: Russia's nascent AIDS epidemic. And many would like Mr Bush to mention Russia's repressed media, biased elections and human-rights abuses in Chechnya and elsewhere. An undemocratic Russia, argue Mr McFaul and others, may become dangerous too. But that argument has so far fallen on deaf ears in Washington. Mr Bush's team, unlike Bill Clinton's, dwells less on Russia's need for democracy.

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Bosnia

Almost like one country

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But poverty may block progress towards reconciliation

A MEMORIAL service this month for some 7,000 Muslim men and boys massacred when the town of Srebrenica fell to Bosnian Serb forces in July 1995 was an unusual affair. It was not just that America's former president, Bill Clinton, was there or that security for the 20,000 people who attended was provided in part by the local Bosnian Serb police. Among the dignitaries was the Bosnian Serb prime minister, who talked about “respect for the dead” and called for reconciliation as well as peace. Even a few years ago such scenes would have been inconceivable.

Now, however, Bosnia's main Serb party sees its top priority as preserving the peace accord signed in Dayton, Ohio, in 1995, which ended the Bosnian war by dividing the country into two parts, one dominated by Serbs, the other jointly by Croats and Bosniaks, as Bosnia's Muslims are now officially known. The Serbs' main party says it has abandoned dreams of a Greater Serbia, into which the Serb parts of Bosnia would simply be absorbed. Likewise, Bosnia's main Croat party says it has abandoned its dream of uniting Bosnia's Croat areas with Croatia.

All sweetness and light, then? Well, on one level things look better. All Bosnians now carry the same passport and can move around the country freely, which they could not do a few years ago. Out of a total of 2.2m refugees or people displaced by the war, some 964,000 have either gone home or reclaimed their properties which they may have sold if they did not want to return. According to the UN's High Commission for Refugees, nearly 420,000 have either returned or reclaimed property in areas where they are now in a minority. Since everyone can either now go home or reclaim and sell their property, the hope is that generations to come will not harbour the same sort of resentment as ejected Palestinians or Cypriots.

Moreover, so many Bosniaks have gone back to the Serb Republic, the Bosnian Serb bit of Bosnia, that their votes now carry weight in elections there. Neither Serbia nor Croatia poses a military threat to Bosnia; and Bosnia's armies have been reduced to very small numbers. So the numbers of foreign peacekeepers in the country have come down.

Yet all this progress may still be reversed. Opinion polls show that the ethnic rivalry that tore the country apart a decade ago no longer bothers ordinary people as much as it did. What they worry most about is jobs. And some fear that the economy is so bad that it could again create ethnic tension and revive the political fortunes of violent nationalists.

Bosnia was always poor, but between the second world war and its civil war in the 1990s its economy was propped up because Yugoslavia's rulers put a huge proportion of the arms industry there, along with other large (and usually unprofitable) industries, to create jobs subsidised by the country's richer parts. All this has gone. After 1995 some of the gap was filled by foreign aid, but that is drying up too. The IMF foresees a drop in aid from $699m in 2000 to $218m in 2007. Many of Bosnia's institutions and companies are deep in debt. Poverty is rising and revenue to pay for Bosnia's many tiers of government is shrinking. The World Bank has given warning of “explosive debt indicators”: in 2000 it cost $130m to service Bosnia's debt, but that figure could rise by 2010 to $883m. Up to 40% of Bosnians have no job.

No one even knows how many Bosnians there are. Before the war there were 4.3m, but today as few as 3.3m may still live in the country. Gerald Knaus, who runs a think-tank in Berlin called the European Stability Initiative, says that foreigners' huge investment in reconciliation in Bosnia has been a success, but that new policies are needed to ensure that all that the money spent (by some counts €17 billion, or $19 billion) is not wasted. He thinks the European Union should step in, “applying the same policies as it has to countries like Greece in the past and now to Romania and Bulgaria—but not Bosnia”. The EU has

embarked on a feasibility study, but Bosnians want EU handouts fast.

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Turkey's poor

Suffer the little children

Sep 25th 2003 | ISTANBUL
From The Economist print edition

Alleviating the plight of Istanbul's street children

GOKHAN YURDUNMALI was barely six when he was put in a state-run home for juveniles in Istanbul. His story is typical. His drunk father could not afford to send him to school. But Gokhan's supposed protectors became his tormentors, beating him as often as his father had. So, aged ten, he joined Istanbul's legion of street children. Home became dank, derelict buildings. His job was shining shoes—or begging. For entertainment he would sniff glue. “I was on the road to self-destruction,” recalls Gokhan, now a wiry 20-year-old. “But then I met my saviour, Yusuf Kulca.”

Once a street urchin himself, who also escaped from a state-run home, Mr Kulca clawed his way to university to get a teacher's degree and in 1992 founded the city's first privately run home, where children are fed and clothed and also taught skills to get them off the streets.

Mr Kulca reckons that the number of what he calls *umut* (hope) children in Istanbul has fallen by more than half, to 2,000 in the past decade, even as the city's population has swollen by another 1.5m to reach 10m. Mr Kulca's success won him support from the World Bank and a post in the ministry for women and children's affairs.

Mr Kulca wants to build a huge sports and education centre on the outskirts of Istanbul as part of his ambitious plans to rehabilitate the urchins. But, as his website explains, his outfit is short of cash, partly because it is hard to stir up sympathy among ordinary Turks. One big reason is that many of them blame the street children for the city's crime wave. Earlier this year a group of youngsters stabbed a colonel to death in the city's main square after he refused to give them money; all but one of them, explains Mr Kulca, were members of a gang ran by the local mafia.

Another reason for people's hostility to the street children (many of them Kurds whose families fled the war in the south-east) is that many are hooked on drugs. “People come and tell me that we should lock them all up on a island somewhere,” says Guldal Aksit, the minister for whom Mr Kulca works. But as long as he is around, there will be hope at least for some of them.

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Charlemagne

Europe should vote

Sep 25th 2003
From The Economist print edition

Why referendums on a new constitution would be good for the European Union

Get article background

FRANÇOIS MITTERRAND, France's late president, once remarked that if you ask a specific question in a referendum you will always get an answer to a completely different one. Many top European politicians, who share Mitterrand's devotion to European unity, also share his suspicion of referendums. European issues, they argue, are too complex and too easily distorted to be subjected to so fickle a procedure. A German official argues that if the Treaty of Rome, which started the process of European integration in 1957, had been put to a vote, “Germans might have rejected it because it raised the price of bananas.”

The dangers of referendums are much on the minds of European politicians at the moment. On October 4th, the heads of government of the EU's 25 current and future members will meet in Rome to start discussing a draft constitution for the Union. But there is a looming fear that the whole exercise may ultimately be futile. Several countries have announced that they will have referendums on any new constitution. If even one of 25 refuses to ratify it, the constitution would be legally dead. If several countries voted against, it would be politically impossible to revive it. According to the European Commission, Denmark, Ireland, Portugal, the Netherlands and Spain will definitely hold votes. Finland, France and Italy are thinking about it, as are several of the central European newcomers. The chances of a rejection, somewhere, have just been underlined by a referendum in Sweden on whether to join Europe's single currency. The result was a decisive no. Shaken by this experience, many EU partisans regard calls for referendums on the constitution as a barely disguised wrecking exercise.

This argument is not only cynical but also unwarrantedly defeatist. It is simply not true that all European referendums are doomed to be lost. On the same day that Sweden voted no to the euro, Estonia became the eighth country this year to vote in favour of joining the EU. Latvia followed suit a week later. All the central European referendums on EU accession have been won by crushing margins. Cynics might argue that poor countries from the former Soviet block have little option but to say yes. But rich Ireland also voted yes in a European referendum last year. Having rejected the Nice treaty of 1999 once, the Irish reversed course in a much more keenly debated second referendum in October last year. The pro-Nice camp in Ireland had always argued that many of the opposition's arguments were “scare tactics” or misrepresentations. When they actually exerted themselves to make this case, they won. Defenders of the European constitution should take heart. They too argue that the text drawn up by a constitutional convention in Brussels has been crudely misrepresented as the death of the European nation-state. In a referendum campaign they would have many months to press home their argument. The Irish experience suggests that they might even win.

In any event, regardless of the result, referendums on European issues serve a vital democratic purpose. Politicians and civil servants in Brussels spend a lot of time searching for ways to “bring Europe closer to the people”. The Irish and Swedish experiences show that referendums are the best way—possibly the only way—to achieve this. For a jaded observer from Brussels it was oddly heartening to get into a taxi in Dublin at the height of the referendum campaign and be treated not to the usual moans about traffic and football but to an expletive-filled tirade against article 133 of the Nice treaty. In a politer, more Nordic way the Swedes also had an intense debate about the euro. The constraints of Europe's stability-and-growth pact, which limits government borrowing, are normally debated only by economists and Brussels nerds. Yet in Sweden, you heard ordinary people discussing the impact of the pact on the Portuguese welfare state.

In normal circumstances, public indifference to EU issues is entirely understandable. People believe, rightly, that such issues are usually decided far away, and above their heads. But give ordinary people a chance to have a say, and the Swedish and Irish experiences show that the great unwashed are perfectly

capable of a proper debate about Europe. Recent experience also shows that a standard argument against referendums—that elected politicians can represent the views of their voters—is questionable when it comes to European issues, where the professional political class is often totally out of tune with public opinion. Ministers from governments who have to attend regular meetings in Brussels often develop reciprocal loyalties to colleagues from other EU countries and gradually accept the logic of the "European project". Doubtless, this mutual understanding is a fine thing in many ways. But it does mean that EU deals—over the constitution, for instance—that seem necessary and inevitable to professional politicians often fail to convince the voters back home. If those deals keep on being made, regardless of what the folks back home think, the EU will lose its democratic legitimacy.

Honest federalists acknowledge it

Some of the more candid and thoughtful advocates of a federal Europe have begun to admit this and to argue for referendums. Pascal Lamy, a European commissioner from France and a self-declared "militant" believer in European unity, argues that holding a referendum on the EU constitution in France is the only way to counteract a growing French Euroscepticism and to "renew the marriage contract between the French and the construction of Europe." Many Liberal Democrats, from Britain's most "pro-European" party, have joined Eurosceptic Tories in calling for a referendum. Even Valéry Giscard d'Estaing, the chairman of the convention that produced the draft, has made favourable noises about referendums, despite the risk that they might destroy his work. Such advocates of European unity have appreciated a simple truth. If a European government is to be created, it can only be with the consent of the governed.

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Public services

Can things only get worse?

Sep 25th 2003
From The Economist print edition

The aftermath of the war is bad enough, but that's not what's really worrying Tony Blair

Get article background

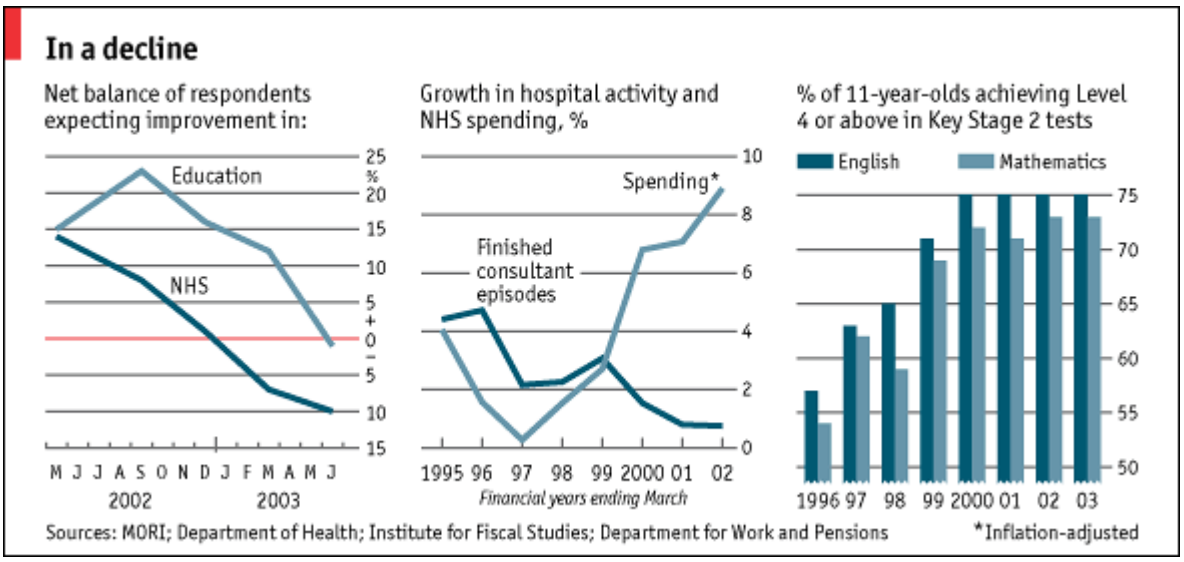
WITH 86 heads of government gathering in New York for a critical meeting to decide the United Nations' future role in Iraq, it could be safely assumed that Tony Blair would be among them. Only he wasn't. Britain may have 12,000 British troops in Iraq and be the current holder of the rotating Security Council presidency, but Mr Blair had a more pressing engagement: a visit to a new wing of King's College Hospital in south London.

Perhaps Mr Blair wanted to put a little distance (literally as well as metaphorically) between himself and George Bush in the week before a tricky Labour Party conference. But, above all, he was signalling that it is the domestic agenda that matters. He knows that Iraq has cost him not only a great deal of political capital, but also a year's worth of focus on improving public services.

Mr Blair is bound to get a rough ride from his party next week over Iraq, foundation hospitals and university tuition fees. But what really worries him is the electorate's verdict. It is not that he fears defeat—even if the polls stay as they are, thanks to the quirks of the British voting system, Mr Blair can look forward to another bumper majority. What keeps him awake at night is the prospect that he will be seen to have failed to deliver on his domestic promises. And failure now seems more likely than not.

According to a YouGov poll, most people think that public services have got worse under Labour. Nor do they expect improvements in health and education, the two areas that matter most to them, according to MORI, another pollster (see chart). Iraq and all that may be partly responsible. But the ebbing in optimism predates the war: people have on balance been gloomy about the government's ability to improve the public services for a year and a half. They have good reason.

Take the National Health Service, electorally the most important public service to sort out. Ministers reel out a long list of achievements. The waiting list has fallen below a million for the first time in ten years; hardly anyone now has to wait more than 12 months for an operation; there are many more nurses; the number of hospital consultants and family doctors is rising.



Given the amount of money going into the health service, it would be very odd if the NHS hadn't managed to hire some more staff. Cash spending this year will be 60% higher than in 1998-99; in real terms the increase is 40%. But the increases in input are not being matched by increases in output. Since spring 1999 the waiting list has fallen by less than 10%.

One reason for the disappointing progress is that a third to two-fifths of the extra money has been swallowed up in higher pay. Doctors complain about the proliferation of bureaucracy in an NHS suffering from targetitis. A study by the Office for National Statistics suggests that NHS productivity has fallen. The growth in hospitals' main activity—the treatments measured by “finished consultant episodes”—has slowed as more money has gone into the NHS.

This makes an unpromising launching-pad for the government's next big target—a maximum waiting time of six months for operations by the end of 2005. This is far more exacting than achieving the 12-month target since it will affect 200,000 patients. In order to meet this target “they will need an increase in activity they haven't been able to deliver so far”, says Adrian Towse, director of the Office of Health Economics, a think-tank funded by the pharmaceutical industry.

The government is now turning to independent and foreign providers to run new fast-track treatment centres for simple elective surgery. But that will mean only about 135,000 extra operations a year, when there were over 5m elective admissions last year. David Green, director of Civitas, a think-tank, says that even with the new centres the government's hopes of reaching the six-month target may be sunk by pent-up demand. In France there are almost twice as many cataract operations per 100,000 persons as in Britain.

In contrast with the NHS, education has been one public service where the public has generally credited Labour with improvement. But here, too, there has been a loss in confidence. And here, too, the public may have a point.

Ministers can certainly point to achievements: record pass-rates for pupils taking GCSEs at 16 and A-levels at 18, and ever more students in higher education. But the sharp improvements in performance by 11-year-olds in Labour's first years in office have levelled off since 2000. Much the same has occurred for school-leavers: the proportion of 19-year-olds with at least a “level 2 qualification”—such as one A-level or five or more GCSEs at grades A* to C—has remained at around 75% over the past four years.

However badly Iraq goes, the greatest crisis Mr Blair faces is the public services' inability to respond proportionately to the huge inputs of expenditure they have received. That failure underlines the need for structural change requiring unremitting focus and effort from the prime minister. Mr Blair is now paying the price for not having applied it.

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Hutton Inquiry

Campbell's diary

Sep 25th 2003
From The Economist print edition

This week's revelations from the Hutton Inquiry are bad for John Scarlett and Geoff Hoon

Reuters

Geoff Hoon, on his way out

Get article background

THE inquiry into the death of David Kelly, the government scientist caught in a row between the government and the BBC, finally ground to a halt this week after two months and millions of words of oral and documentary evidence. As Lord Hutton prepares to write his report, he will examine the obsessiveness with which the government and the BBC pursued their mutual quarrel. He will also be considering the extent to which Dr Kelly was right to complain, and the BBC to report, that the government “sexed up” intelligence in the run-up to the Iraq war.

John Scarlett, chairman of the Joint Intelligence Committee, which brings together the chiefs of the intelligence services, admitted that he had materially strengthened the dossier published a year ago on the threat from Iraq's weapons, after being “prompted” by Downing Street's chief of staff, Jonathan Powell. Mr Powell had objected to a statement that Saddam Hussein would use chemical and biological weapons “if he believes his regime is under threat”: as Mr Powell pointed out, this might be used as an argument against attacking him. This phrase was removed from the final draft—though not, Mr Scarlett insisted, at Mr Powell's behest, but as the result of “the exercise of my professional judgment”.

A report earlier this month by Parliament's Intelligence and Security Committee acquitted the intelligence services of having done the government's bidding in “sexing up” the dossier. And most of the evidence to the Hutton Inquiry appears to support that judgment. But there is cause for concern about the politicisation of intelligence. Malcolm Rifkind, a former foreign secretary, has pointed out that the intelligence services are not supposed to be “an arm of government”. Mr Scarlett's obliging behaviour suggests little distance between the two.

The personal diary of Alastair Campbell, Downing Street's outgoing director of communications, shows how determined he and the defence secretary, Geoff Hoon, were “to out” Dr Kelly as the BBC's source for the report broadcast on radio by Andrew Gilligan, the “Today” programme's defence correspondent. The entry for July 4th read: “GH and I agreed it would fuck Gilligan if [Dr Kelly] was his source.” Even allowing for Mr Campbell's colourful use of language, it indicates just how obsessed he was by the BBC's refusal to back down. “I don't deny,” he told the inquiry, “that I was very, very angry and frustrated

about this whole situation.”

Successive diary entries show that Tony Blair repeatedly urged caution on his communications director. He wanted Dr Kelly to be treated fairly, in line with the advice offered by senior civil service advisers. Perhaps the last and most valuable service that Mr Campbell has done for the prime minister is to ensure that he is one of the few people to come out of this affair looking decent, if a little ineffectual. This may provide an answer to the puzzle about why Mr Campbell made his personal diary available to the inquiry. It is not clear that he was legally required to produce it. Cynical observers have also noted that disclosure may have increased the diary's market value.

Mr Campbell's diary may have helped the prime minister but it has been a disaster for the defence secretary. When one of the lawyers accused Mr Hoon of being party to a government strategy to leak Dr Kelly's name to the press, he replied: “I don't believe that there is the slightest shred of evidence for that assertion.” But within hours of that statement, detailed extracts from the diary suggested that the defence secretary had been “steamed up” in his determination to get Dr Kelly's name out in the public arena. On July 6th, Mr Campbell wrote: “GH and I both wanted to get the source [Dr Kelly] up but TB [Tony Blair] was nervous about it.”

The diary entries suggest that the defence secretary was, at the least, an enthusiastic accomplice in Mr Campbell's determination to get Dr Kelly's name into the public arena. Lord Hutton is likely to criticise the strategy that was eventually decided on—dribbling the name out through the Ministry of Defence's press office. Even before the inquiry began, Mr Hoon was seen at Westminster as the inquiry's most likely political victim. After his half-evasive, half-belligerent performance this week, his political future looks bleak.

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Northern Ireland

Please police me

Sep 25th 2003
From The Economist print edition

Attacks on police in Northern Ireland may, strangely, be a sign of progress

Get article background

THE odd-shaped package with protruding wires discovered on September 24th in a small County Tyrone village caused panic. Houses were evacuated. The army detonated the package, only to find that it contained no explosives. It did, however, bear the hallmarks of a campaign to discourage Catholic engagement with the restructured Northern Ireland police service: the target was a 51-year-old bank employee who joined the “district policing partnership” as public-spirited citizen, not as a political activist.

Policing is a crucial issue in Northern Ireland, not just because no state works unless the people accept the police, but also because getting Sinn Fein, the IRA's political wing, to support a reformed police service is a central part of the failing peace process. The old-style Royal Ulster Constabulary (RUC) could never disguise its roots as a paramilitary defence force fighting on behalf of an embattled Protestant state, and some dirt clings to its successor. But the flow of new Catholic recruits suggests that Catholic opinion is shifting in favour of the police. That may be one reason for a recent spate of attacks.

In the past month, noisy pickets have disrupted meetings between police commanders and locals. The pickets and attacks have all been in mainly rural Northern Ireland west of the river Bann—an overwhelmingly Catholic, nationalist region. Most of the cars and homes targeted belong to members of the moderate nationalist SDLP, which came out in favour of the police service two years ago.

Better relations between Catholics and the police are in part down to Hugh Orde, the newish, media-friendly chief constable. A former senior officer in London's Metropolitan Police, he arrived in Belfast as deputy head of an inquiry into collusion between the RUC, the army and loyalist paramilitaries. The inquiry uncovered collusion between these parties, and pointed the finger in particular at Special Branch's use of double agents.

Mr Orde made no secret of his distaste for what was uncovered. His attempts at reform have not been entirely successful, thanks to residual antagonism within Special Branch—a failing that Tom Constantine, the American oversight commissioner of reform, and Sinn Fein have been quick to point out. But at least he has shown some stomach for confrontation.

The force now takes on equal numbers of Catholics and Protestants, no matter how many applications are received from each group. Once, the RUC was 7% Catholic. Now it is 13%. And optimists hope that, by 2011, it will be 29% Catholic—well short of the 43% that would make it truly representative, but an improvement.

So who is behind the pickets and bombings, and what are they designed to achieve? Police mostly blame the Real IRA and other hardline opponents of the peace process for most attacks. But Mr Orde says that intelligence in one district points to low-level supporters of mainstream republicanism. They may be worried that their leadership will throw its weight behind the police as part of the revived negotiations to restore devolved government in Northern Ireland. So it's possible that the attacks are a sign of progress.

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David Blaine

Empty box

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The many meanings of a publicity stunt

DAVID BLAINE, a handsome American magician, is trying to survive for 44 days inside a plastic box near Tower Bridge, in London, eating nothing and drinking only water. As a spectacle, it is less than compelling ("Is he dead?" asks one disappointed teenager). But that is not the point. After three weeks, the true purpose of this performance has become clear: to provide people with an excuse for theorising about themselves. Mr Blaine, it turns out, is not so much a man in a box as an empty box.

Even those who congregate on the south bank of the Thames appear less interested in what Mr Blaine is doing than in what others think of him. Pet theories are eagerly listened to; ugly incidents are analysed. There have been many. Mr Blaine has been bombarded with golf balls and sausages, and kept awake by drummers. Fights have broken out, one of them involving Sir Paul McCartney, a normally placid singer.

Commentators are divided on the meaning of all this. One camp regards the assaults as a charming display of native scepticism, while the other frets over the degradation of morals. The *Daily Mail* calls the attacks "an alarming reflection of something rather unpleasant lurking in the British psyche." The proper British reaction would be to ignore Mr Blaine, the newspaper suggests.

That unpleasant something is more clearly visible from overseas. American analysts have been the most discerning, none more so than the *Philadelphia Inquirer*, which attributes the Blaine-baiting to simmering class tensions: "Even in the 21st century, Britons can be uncomfortable with ambition and disparage people with high aspirations as not 'knowing their place'."

Such po-faced comments delight Commonwealth observers, who have seized on the evidence of a British-American cultural divide and asserted their affinity with the larrikins. The attacks were "probably inevitable", says the *Australian*. The *Edmonton Journal* reckons that, "like many American tourists", Mr Blaine simply doesn't understand the British dislike of pomposity.

Fomenting domestic strife, challenging the class system, pulling nations apart and bringing others together: not bad going, for a man in a box.

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Genetically modified foods

Sour taste

Sep 25th 2003
From The Economist print edition

Britons don't want scientists meddling with crops. It's official

Get article background

IF, AS the government assumed, public hostility to genetically modified foods was based on ignorance, then surely education would change people's minds? It was in that spirit that a six-week public consultation exercise, called GM Nation?, was launched in June, to find out what people thought of GM and to get them to debate its pros and cons. Later this year the government will decide whether or not to allow commercial cultivation of GM crops, and it is worried about public hostility.

This week, after nearly 700 public meetings and more than 37,000 questionnaires returned, the government published the results. Those in favour of GM agriculture will find them hard to swallow. Few of those who took part want to see commercial cultivation of GM crops in Britain any time soon. While some accepted that GM technology could do good, particularly for poor countries, concerns about the effects of GM crops on the environment and human health led most to call for anything from more research to an outright ban in Britain. Interestingly, the more some participants learned about GM foods the more worried they became. Most also wanted a reliable, independent body to address safety concerns.

This rules out government and big business, as far as most participants were concerned. They suspected the government of having already made up its mind on GM foods, irrespective of the outcome of GM Nation?, and some drew explicit parallels to Tony Blair's rejection of public protests over the war in Iraq. Many also distrust the GM companies, their information campaigns and industry-sponsored research. They doubt that such firms would deliver any of the possible benefits of GM crops. “The mood,” concludes the report, “ranged from caution and doubt, through suspicion and scepticism, to hostility and rejection...these attitudes far outweighed any degree of support or enthusiasm for GM.”

This is not the first government-sponsored study to pour cold water on GM foods. In July, a review of the economic consequences of growing GM crops in Britain concluded that there were few benefits for either farmers or consumers from the current generation of GM plants. Another government-funded study, looking into scientific evidence of risks and benefits of GM to human health and the environment, concluded that there were still plenty of unanswered questions about the effects of such crops.

All eyes are now on the results of field trials, which have examined the impact of four types of GM crops on British farmland biodiversity and wildlife compared with conventional weed control. The government has said that these results, due to be published next month, will be crucial to its decision whether or not to go ahead with GM crops. It will be in a difficult position if, while GM Nation? has shown that the public don't want the stuff, the field trials show that GM crops are no riskier than conventional farming practice.

Before the debate started, the anti-GM lobby said that it was unrepresentative and underfunded. Now it is the pro-GM lobby that says that. Some 79% of responses, maintains the Agricultural Biotechnology Council, are clearly orchestrated by activists. That, it argues, leaves fewer than 4,500 “genuine” responses; which, compared with the half-million who voted to decide which decrepit house the BBC's “Restoration” programme should rebuild, is a tiny response and therefore should not influence policy.

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Council tax

Can't pay, won't pay

Sep 25th 2003
From The Economist print edition

Another financial headache for the chancellor

IN 1990, protestors against the poll tax chanted “can't pay, won't pay”. Their opposition culminated in riots and helped to bring Margaret Thatcher down. Under John Major, the government replaced the poll tax in 1993 with the council tax.

Now a group of pensioners in the south-west are making a peaceful but politically potent protest against the council tax. Some are saying that they are prepared to go to prison rather than pay this year's increase. The Devon and Cornwall Police Authority has given warning of possible civil unrest over high bills.

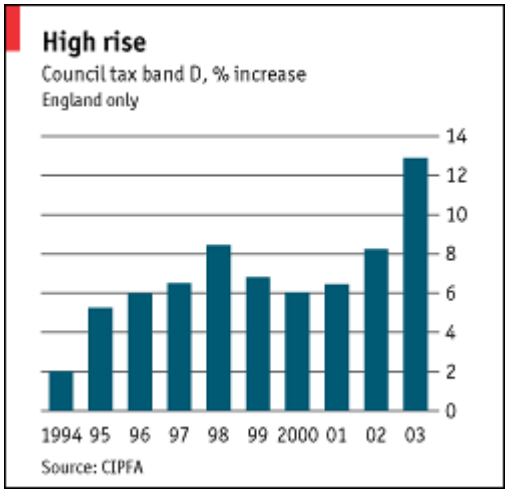
In Labour's first six years of office, council-tax demands rose consistently by well above the rate of inflation. This year, however, bills have leapt by an average of 13% in England. The increases have been especially high in the south. In Devon, for example, where many of the pensioner protests are occurring, council tax increased this year by over 18%.

The government blames spendthrift local authorities; councils for their part blame ministers who fail to provide the money for the extra local services that they demand. A new funding formula has undoubtedly had a redistributive effect, shifting money from the richer south to the poorer north. Since Britain's local-government finance is as mystifying as the Schleswig-Holstein question, just about everyone has been taken aback at the scale of the increases: “the government didn't expect this brouhaha,” says Tony Travers of the London School of Economics.

The protest highlights the unsatisfactory fiscal arrangements of Britain's local government. Councils are expected to provide vital services, such as schools, but are not in overall charge of their finances. The council tax pays for only a quarter of their average spending. The rest comes from central government through grants paid from general taxation that are supposed to match resources with local need.

This dependence on central-government funding means that local authorities have to push up council tax a lot if there is a shortfall in the money they receive. Suppose, for example, a council receives 3.5% more in its grant—the floor increase this year for councils with education responsibilities—but has to spend 5% more in total. Because council tax raises only a quarter of total revenue, the local authority will have to raise it by 9.5% to make up the gap.

Nick Raynsford, the local-government minister, has conceded that bills are reaching the “limit of acceptability” for many families. But the Treasury's public spending plans for next year assume a 7% increase in expenditure financed by the council tax. In 2005-06, when an election is due, the Treasury is assuming a further rise of 6%. Even if the increases in council tax could be held to 6-7%, the funding formula is likely to lead to considerably higher increases in some local authorities.



Gordon Brown faces an unpalatable choice. Either the chancellor sticks to his existing plans, in which case council-tax bills will jump again and the protests will multiply. Or he will have to find more money for local authorities than he was planning. That will add to an already worryingly large budget deficit, or mean raising taxes such as business rates.

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ID cards

Who am I?

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From The Economist print edition

The government is moving towards introducing a national identity card

POLITICIANS do not often admit that they don't have a grip on a problem that bothers voters, so why did David Blunkett, the home secretary, this week say that he had no idea how many illegal immigrants there were in Britain? In order to imply that, if Britons carried the identity cards he favours, he would be better placed to keep undesirables out.

The argument about whether or not Britons should have ID cards, which has been dragging on for years, finally seems to be reaching a conclusion. The cabinet, which is divided, has yet to take a final decision, but Mr Blunkett is pretty sure that he will win. Otherwise he would not have admitted this week that there was an argument going on.

Details have been delegated to the cabinet's domestic affairs committee, which has been given six weeks to reach agreement before MPs return for the new session in November. Mr Blunkett has the backing of Tony Blair and John Reid, the health secretary, who is concerned by the tens of thousands of foreigners (uncounted and uncountable) who are believed to turn up in Britain to get their operations done free of charge on the National Health Service. The deputy prime minister, John Prescott, is in favour in principle, but he is said to have doubts about the practicality and the timing.

The chancellor, Gordon Brown, is at best lukewarm about the idea. He has made it clear that he will not pay a penny of the cost. Immigration, illegal as well as legal, has helped boost economic growth, so the Treasury has little reason to want to see it curbed. And cynics suggest that Mr Brown is not rushing to deliver what could be quite a coup to Mr Blunkett, who is his nearest rival for the succession. Brownites in the cabinet, including the transport secretary, Alistair Darling, and the pensions secretary, Andrew Smith, are sceptical. And Patricia Hewitt, the trade and industry secretary, who was once the director of the National Council for Civil Liberties, is worried about the potential implications for personal freedoms.

Given the division of opinion in the cabinet, it will need a determined push from the prime minister for legislation to be introduced in the Queen's Speech in November. Advocates of ID cards point out that, whatever Britain decides, new European Union passports are likely to include biometric data (such as retinal scans or fingerprints) from 2005.

Mr Blunkett has been careful not to overstate the advantages of ID cards. They would not be much help in combating terrorism or crime (apart from benefit fraud). But his argument on illegal immigration seems to strike a chord with voters, around 80% of whom are in favour of ID cards. They are, however, less keen on having to pay for the things, which will cost, the Home Office estimates, at least £40 per person. The overall cost of the scheme has been variously estimated at £1.3 billion for a simple plastic card to more than £3 billion for a card with biometric data.

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Bagehot

Charles Kennedy's new strategy

Sep 25th 2003
From The Economist print edition

After their by-election victory, the Liberal Democrats scent Tory blood

Get article background

IT'S hard not to feel a twinge of sympathy for Iain Duncan Smith. By describing the Liberal Democrats' spectacular by-election victory in London's Brent East as a “strategic blunder”, the Conservative Party leader made himself look a fool. But his frustration is understandable.

If it walks like a duck and talks like a duck, it's probably a duck. And at their conference in Brighton this week, as usual, the Lib Dems have been walking and talking like a pretty left-wing party. How, Mr Duncan Smith wonders, can middle class swing voters in marginal constituencies, irked by the government's reversion to tax-and-spend, contemplate voting for a party that wants to spend even more of their money? Tunes that played well for the Lib Dems in run-down, inner city, multicultural Brent East should fall on deaf ears in seats like affluent, rural Newbury that the Tories must regain at the next election if they are to make any progress.

Unfortunately for Mr Duncan Smith, there is not the slightest sign of the Liberal Democrats losing their grip on the once-safe Conservative constituencies they now hold. Indeed, on their present showing—a solid 30% share of the vote in recent local elections and 28% in the first post-Brent opinion poll—the Liberal Democrats can look forward to taking a further handful of Tory scalps come the next election. Of the Lib Dems' top 20 target seats, 16 are currently held by the Conservatives. Among those vulnerable to the slightest swing are: the party chairman, Theresa May; the shadow deputy prime minister, David Davis; and the shadow home secretary, Oliver Letwin. No wonder senior Lib Dems in Brighton were rubbing their hands and talking about a “decapitation strategy” that would carry off some of the best-known names on the Tory frontbench.

Terrified, the Conservatives increasingly believe that their only hope of avoiding such a fate is to succeed in painting the Lib Dems in their true colours. Hence Mr Duncan Smith's angry incomprehension and inarticulately expressed hope that the Brent East result might yet play into his hands. Hence also a two-page attempted demolition job this week in the *Sun* on the Lib Dem leader, Charles “Red” Kennedy.

So far all such attempts have failed. If proof were needed, a poll in the *Times* showed how the Lib Dems are almost perfectly positioned to woo the disillusioned supporters of both parties. While Labour voters reckon that the Lib Dems are, these days, well to the left of their party, Conservatives seem to think they are to the right of Labour. It's easy to see why Labour voters who were against the war and don't like the government's policies on foundation hospitals and university top-up fees might be tempted by a flutter on the Lib Dems. It's harder to understand what the appeal is to fed-up Tories. Surely Mr Duncan Smith is right to predict that success for the Lib Dems of the Brent East kind will draw attention to the mismatch between their policies and the voters they must attract?

That is the conventional wisdom, but it is almost certainly wrong. The party's strategists argue that all this left-wing, right-wing stuff is terribly last century and a sign that those who use such labels—mainly stuck-in-the-mud political commentators—just don't get it. Mr Kennedy's stand on Iraq is a case in point. Many traditional Tories were uneasy about the war and, particularly since its messy aftermath, are sympathetic to criticism of Tony Blair and George Bush.

If opposition to the war was a big and risky gamble for Mr Kennedy, the commitment to raise taxes is less so. It helps that few voters actually believe there is any chance of Matthew Taylor, the Lib Dems' treasury spokesman, finding himself in a position to make their pips squeak. But the activists like it because it makes the party seem honest and caring. In any case, only those earning £100,000

($160,000) a year would face a higher marginal rate than today. Some of the extra money raised would go towards scrapping university tuition fees—a straightforward bribe for the middle classes—while the rest would be spent on getting rid of all health-related charges for the sick and elderly.

The proposal to replace the property-based council tax with a local income tax is more controversial. “Only” the richest 20% would end up paying more, but that is a lot of people. On the other hand, most pensioners, a good many of them Tories eking out their days on fixed incomes, would be much better off.

Neither left nor right

That said, Mr Kennedy knows that simply promising to outspend a government which may already be reaching the limits of what the public services can sensibly absorb is not enough. The Lib Dems' big new theme—pruning the size of central government by getting rid of entire Whitehall departments and decentralising public service delivery—is one that has no obviously right-wing or left-wing label attached to it. Echoes of a Thatcher-style war on bureaucratic waste combine with a critique of this government's damaging addiction to centrally-imposed targets. The “new localism” has become fashionable among many. But the Lib Dems, whose main power-base lies in local government, and who have always been strong in grass-roots campaigning, can claim to have got there first.

Mr Duncan Smith will flail away for all he's worth in an effort to demonstrate the “unpopulism” of Lib Dem attitudes towards crime, asylum-seekers and Europe. But somehow, the blows never quite seem to land, the charges never quite stick. Just as the electorate has made up its mind, however unfairly, that the Conservative Party leader is a dim, right-wing, no-hoper, so it has also concluded that Mr Kennedy, while not necessarily of prime ministerial calibre, is a moderate, commonsensical sort of chap. That alone makes it highly likely that those well-known Tory heads will roll.

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Manufacturing and politics

The misery of manufacturing

Sep 25th 2003 | BRUSSELS, CHICAGO, LONDON, NEW YORK, TOKYO
From The Economist print edition

Corbis

Why there is a new panic over manufacturing in the rich world

RICH-COUNTRY manufacturing has supposedly been in decline for so long that it is surprising that the politicians, unions and journalists who leap so nobly to its defence find much left to save. But they do: after years of silence on this hoariest of economic fallacies—that manufacturing is something special—the alarm bells are now ringing louder than ever. American politicians are rushing to aid the manufacturing lobby. In Britain the rebranded engineering workers union, Amicus, is raising the issue to embarrass the government at the Labour Party conference next week; it is asking for a minister for manufacturing and loads of government help.

Politicians love manufacturing because it provides lots of visible, reasonably well-paid jobs. That is why American states fight each other with subsidies to land each new Japanese car-assembly plant, and central European countries do the same, knowing that no new car factories will be built in western Europe.

In Japan, politicians decry the “hollowing out” of Japanese manufacturing, as large-firm production seems to flee offshore. In Europe, the French are normally stoutest in defence of their national champions. But Germany is newly fierce; its chancellor, Gerhard Schröder, has picked a fight with the European Commission, denouncing its “anti-industrial bias” as it seeks to stop subsidised state loans and other favours for German industry.

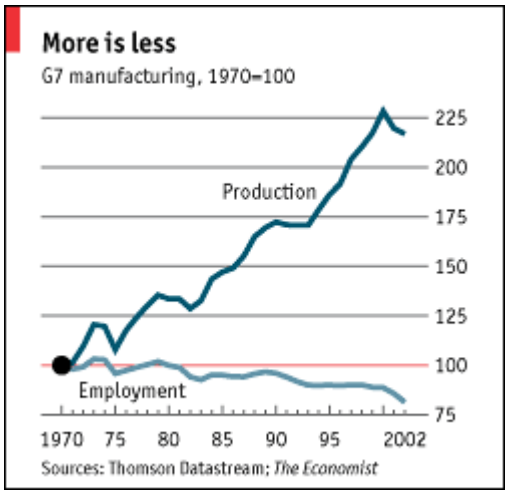
Maybe this onslaught on the commission explains why its president, Romano Prodi, wrote plaintively in *Le Monde* this week of the “deindustrialisation of Europe”. But at least another Italian economist, the competition commissioner Mario Monti, is questioning yet another French bail-out, this time of an engineering giant, Alstom, where around 100,000 French jobs are at risk (see article).

Made (too much of) in America

But the clamour is loudest in America. In the 1980s, the enemy was Japan: now it is China. “Walk around Wal-Mart,” says Jack Smith, until this spring chairman of General Motors, “and it looks as if everything is made in China.” This week, America's National Association of Manufacturers (NAM) resolved to press Congress to sanction China for “manipulating” its currency markets (ie, keeping its exchange rate low).

Protectionist bills may begin to proliferate in Washington DC. John Snow, the treasury secretary, jawbones the Chinese about the yuan. George Bush has a raft of initiatives to keep manufacturers afloat, including a new office at the Commerce Department to monitor unfair trade, and an assistant secretary to co-ordinate manufacturing policies. The anti-Japan campaign in the 1980s wreaked havoc on international trade relations and currency markets. What will happen in the China row?

One minor obstacle, then as now, is the awkwardness of facts. Manufacturing has only recently, and with unusual lethargy, emerged from a global recession. (From a peak in June 2000 to a trough in December 2001, manufacturing output shrank by 7.6% in America.) But, on a longer view, rich-world manufacturing is in terrific shape (see chart). Amicus may have a point that Britain under-performs its peers in manufacturing. But that is only because Britain's competitors—particularly America—have done so well. Since 1970, America's manufacturing output has more than doubled. Even after the recession, American manufacturing output is almost 50% higher than in 1992.



What really animates the China-bashers, of course, is not the decline of manufacturing, but the loss of rich-world manufacturing jobs, as firms cut payrolls by using more sophisticated processes. In 1947, according to the Federal Reserve Bank of Chicago, 35% of America's workforce were employed in manufacturing. By 2002, this figure had fallen to just 12%. With employment falling and output rising, America has enjoyed soaring manufacturing productivity, a feat repeated to some extent elsewhere in the rich world. On the one hand, NAM suggests that “manufacturing's future in America is now in jeopardy”. On the other, NAM boasts that American manufacturing is “innovative, productive and efficient”. Which is it?

The Chinese facts are even more awkward. What alarmists really hear when they tune into the “giant sucking sound” (or whatever) of American factories disappearing into China is mostly the continuing stampede of its firms into other rich countries' markets. Though growing rapidly, American manufacturing investment in China is still a trickle compared to the far larger flows into other rich countries.

Despite the pull of China's cheap labour, firms find lots of reasons to keep lots of manufacturing at home. One is that, as rich-country factories employ fewer workers, labour costs no longer make or break decisions about where to put a factory. Frank Vargo of NAM, for instance, calculates that payroll costs account for just 11% of overall manufacturing costs in America. Because shipping costs and speedy distribution are more important than relative wages, Dell builds its computer-assembly plants near to its customers, both in rich and poor countries. Moreover, Mike Kilgore, a consultant with Chainalytics in Atlanta, says firms often underestimate the cost of overseas manufacturing, particularly those associated with transportation, extra inventory, and political and security risks. Meanwhile, growing demand for prompt delivery from retailers such as Wal-Mart in America and Carrefour in France also pulls manufacturing home.

Primitive mercantilist views about the piling up of foreign currency by a nation selling more than it buys from abroad still rule in parts of Europe, notably Paris. In Britain, on the other hand, the unions may find their latest campaign tough going. The Labour government of Tony Blair has, at least until now, cast off its old pro-manufacturing socialist bias and embraced the mostly neutral policies towards manufacturing of its Conservative predecessor. Amicus's pleas over the 2,500 manufacturing jobs it claims are lost in Britain every week will probably fall on deaf ears in Britain, which despite slow economic growth still has more or less full employment—unlike America or Japan.

In Japan China is a favourite bugbear of nationalist politicians—and Japanese racists in general. Yet the ruling Liberal Democratic Party finds some of its baser instincts leavened by its desire to please big Japanese manufacturers, such as the car companies and electronics firms, which are finding both selling to and investing in China so attractive.

Hopefully, similar common sense will prevail in America, where big firms are indeed worried about growing protectionist sentiment towards China. But it may not. America's presidential elections next year will follow a recession that has cost 2.7m jobs. Politicians will feel the sharp anger of thousands of smaller American manufacturers, from furniture firms in North Carolina to car-parts makers in the Midwest. These firms really are taking a beating from China. An early test of Mr Bush's mettle will be how he handles a review of America's steel tariffs, slapped on 18 months ago at the behest of its ailing

foundries. Expect more fireworks.

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State aid in Europe

Rescuing Alstom

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From The Economist print edition

Has Mario Monti been tough enough on the French government?

MARIO MONTI, the European Union's competition commissioner, is used to high-profile fights over mergers and state aid. But he says that “it is difficult to imagine a case where the political pressures could be greater” than over his review of the French government's plans to rescue Alstom, a heavy-engineering group that makes France's much-lauded high-speed trains and employs over 110,000 people. In the run-up to his decision, Mr Monti received agitated phone calls from Jacques Chirac, the president of France, and much abuse in the French press. On September 22nd he agreed that Alstom could be saved—at least for now.

Mr Monti argues that he took a tough stand that preserved the integrity of the EU's rules, aimed at preventing national governments from distorting Europe's single market by subsidising firms. By threatening to take out an injunction, he forced the French government to restructure its rescue package. France's aid to Alstom will now be in the form of loans and bonds, not a purchase of shares. Mr Monti says this means that the package is reversible. He will now assess the aid deal over the next six months. In theory, he could refuse permission and force France to reclaim the money.

But is this the triumph for the rule of European law that the Brussels authorities would have people believe? Mr Monti's intervention has actually led to an increase in the amount of money that the French government is advancing to Alstom—from €600m ($688m) to €800m. And, whenever Mr Monti hands down a final decision, will he really be willing to take a stand that results in Alstom's demise? True, he has presided over a sharp fall in state aid in the EU. But the political pressures to keep the firm going mean that the real struggle will probably be over what assets Alstom is forced to sell. Even if he decides that the Alstom deal violates state-aid rules, there is no guarantee that the French government would then meekly withdraw the aid from the firm. France is still dragging its feet over reclaiming €450m it extended to Groupe Bull, a computer maker, in 2001-02.

Mr Monti made much this week of the need to send a signal that European law will be applied to all countries equally—whatever their size and political muscle. It is indeed a particularly important moment to make this point. Ten countries are to join the EU in 2004. Most of them are in central Europe, where there is no lack of loss-making firms with large numbers of employees. One danger of the Alstom deal is that the central Europeans will conclude that if you make enough fuss about a “strategic” industry that is “too big to fail”, the European Commission will ultimately find a way to help you out.

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Television in India

Star turns

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Rupert Murdoch battles on in India

MANY countries fear foreign control of their news media, especially when the foreigner is Rupert Murdoch. India, where suspicion of multinational firms runs deep in everything from soft drinks to accountancy, has more qualms than most. Star News, a Hindi-language news channel produced by a scion of Mr Murdoch's News Corp, has had to jump through a series of regulatory hoops. The Indian market, it seems, is worth a few contortions.

Star News launched as a Hindi-language channel on April 1st, replacing Star's previous tie-up with NDTV, a local broadcaster. A week earlier, ownership rules were changed, limiting foreign investors to 26% of the shares in TV-news channels (as in newspapers). Star duly found six friendly Indian investors to take up 74% of Media Content and Communication Services (MCCS), its Indian editorial firm.

There followed a vitriolic campaign by the Indian Media Group, a hastily cobbled-together lobby of local publishers and broadcasters. Star was accused of flouting the rules by diluting ownership but not control. Again, the government heeded the vested interests and changed the rules, so that a single Indian investor had to have at least 51% of the company.

Meanwhile, Star kept broadcasting thanks to a series of temporary approvals. But this week, MCCS was at last able to file what should be a compliant application for a ten-year licence. Anand Bazar Patrika (ABP), a Kolkata-based publisher, has acquired the six friends' 74% stake.

Star's persistence highlights the potential of the Indian market. About 44m Indian households, some 22% of the total, have cable TV, the third-largest subscriber base in the world. Star has a very successful “bouquet” of channels, covering movies, music and sport, and Star Plus, which offers Hindi-language entertainment. Last week, this channel broadcast all of India's 20 most-watched cable TV programmes. Star News, too, is gaining market share. According to TAM Media Research it now reaches 27% of viewers, just behind the market leader, Aaj Tak, with 29%.

The difficulty is in turning all these viewers into money. In India, the “last-mile” delivery of cable TV is controlled by some 30,000 small-time operators, many of whom fiddle their returns and hang on to most of the subscription fees. India's cable-TV industry generates annual revenue of about $2.3 billion. Of this about a quarter comes from advertising and the rest from subscriptions, of which less than a tenth reaches broadcasters.

In theory, government plans should help plug this leakage by introducing a “conditional-access system” relying on set-top boxes to monitor viewing. But implementation has been botched, so far.

One broadcaster, Star's erstwhile partner and now rival, Zee TV, has been awarded a licence for a “direct-to-home” (DTH), satellite-based service, for those who can afford a dish. Star's Space TV has also applied for a DTH licence. It seems close to a partnership agreement with the big Tata conglomerate, but officials at the information and broadcasting ministry reckon it is four to five months behind Zee.

If it works, DTH would cut out the cable bandits. But the worries of foreign broadcasters such as Star might still not be over. A new campaign is brewing to demand that entertainment channels be subject to the same foreign-ownership restrictions as news, and that all satellite channels be transmitted from inside India. Politicians will be tempted to meddle further. Bashing foreign companies is always easier than defending them. It is just a shame that their programmes are so popular.

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Online chat rooms

Shut up

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What is the real reason Microsoft is planning to close its free chat rooms?

INTERNET chat rooms, always garrulous, are even more abuzz than usual. Microsoft's MSN online service plans to close its free chat rooms in over 25 countries next month due to problems caused by spam and paedophiles, keeping open only those in America, Canada, Australasia, Japan and Brazil. Most users will have to subscribe to an MSN service—and so be traceable via billing details—to participate. Elsewhere, the decision to close the real-time text-discussion forums will affect millions of users.

This being Microsoft, pundits raced to find ulterior motives for the software company's actions. In some cases, the move requires users to become MSN customers in order to participate in what is now free, giving rise to speculation that Microsoft is using the cloak of corporate citizenship to hide its financial motives. The chat rooms never generated a profit from user fees or advertising revenue.

Though Microsoft's finances may benefit, this misses the bigger issue—and bigger danger. Microsoft has launched a “trustworthy computing” crusade to protect intellectual property, is scrambling to patch software code that is vulnerable to viruses, and is working with industry and government to find ways to reduce spam. Closing the chat rooms is in line with the firm's goals of making the internet safe for commerce and friendly for kids. By shifting users into its online service, it raises the height of the gate to its walled garden.

This comes at a price. Protecting minors from online dangers is necessary. But Microsoft's approach goes against fundamental aspects of the internet, notably its openness and anonymity, that have helped it to thrive as an instrument for free expression. Many industry experts think that the firm could have found other solutions to chat-room problems than eliminating them altogether.

Yet the move has a degree of inevitability about it. When the internet first went mainstream, it seemed to be beyond the jurisdiction of governments. That view is now acknowledged as folly. But a question remains over what legal authority can make internet rules that will actually work, and then enforce them. In this case, the private sector is pursuing policies to uphold what it thinks is the public interest. Ultimately, on the internet, freedom of assembly depends on who owns the meeting hall.

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Motorola

The ties that no longer bind

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How will Motorola manage without a Galvin at the helm?

THESE are tough times for the offspring of corporate legends. Umberto Agnelli and Bill Ford are both struggling to keep alive the huge public companies founded by their forefathers. On September 17th, Christopher Galvin, grandson of the founder of Motorola, gave up his struggle. He submitted his resignation as chairman of the sprawling Chicago giant to the company's board, which announced it publicly two days later.

Investors cheered. On Monday September 22nd, Motorola's share price rose by 9% as analysts raised their ratings of the ailing conglomerate best known for its mobile phones. They also helped provide Mr Galvin with a consoling windfall. The increase added some $18m to the value of his $200m holding in the company.

Motorola has been in need of a new lease of life since before Mr Galvin took over as head of the company in 1997. Under his father, Robert Galvin, Motorola had squandered a fortune on the ill-fated Iridium satellite phone. And it was on the verge of losing its dominance of the mobile-phone market to Nokia after having missed the crucial shift in mobile technology from analogue to digital. The younger Mr Galvin has done little to stop the rot. The company's share of the mobile-phone market (which accounts for 40% of its revenues) continues to fall. And, despite laying off 56,000 employees and closing plants, Motorola is still making huge losses.

The final straw came last week when Mr Galvin disagreed with his board over the pace and direction of change. The board, traditionally stuffed with Galvin family acolytes, has been restocked in recent years with a number of powerful outsiders. They have less sentimental attachment to the firm's family history. Mr Galvin's departure came just before Motorola marked its 75th anniversary. It is now left to contemplate its future without a Galvin family member at the helm almost for the first time in its history.

The board's outsiders include Indra Nooyi, a senior executive at Pepsico and a former vice-president of corporate strategy at Motorola in more profitable times (she left in the mid-1990s), and Douglas “Sandy” Warner, a former chairman of J.P. Morgan Chase, a bank. The most powerful influence on the board, however, is probably John Pepper, a former chief executive of Procter & Gamble, who has brought valuable experience in the marketing of consumer products.

He is now in charge of the search for Mr Galvin's successor. The leading inside candidate for the job is Mike Zafirovski, who joined Motorola in 2000 after over two decades at General Electric. Although a member of the board, he was in Europe on company business when Mr Galvin's departure was announced. The news came as much of a shock to him as it did to every other company employee.

Analysts think that the first task of Mr Galvin's successor should be to sell off some of the company's diverse businesses, with its loss-making semiconductor operation and its struggling wireless-infrastructure business as prime candidates. Late last year, the firm talked to Siemens about swapping the wireless operation for the German conglomerate's mobile-phone business. But Mr Galvin's reservations at the time prevented a deal going ahead.

Sam May, an analyst with US Bancorp Piper Jaffrey, says that the next chief executive will need experience in managing a big, diversified portfolio. As a result, he thinks the job will go to an outsider. “This isn't as simple as running Microsoft or Intel or a biotech company,” he says. “You've got to be able

to identify an agenda and move forward on not just one or two platforms, but four or five".

That challenge was beyond the capabilities of the nice Mr Galvin, as it may yet prove to be beyond the capabilities of the gentlemanly Mr Agnelli and the wholesome Mr Ford. The grandsons of very rich and successful businessmen rarely have what it takes to make great fortunes. Motorola has been a public company now for over 60 years. The break with its family origins was long overdue.

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Video games

Sunny the vampire-slayer

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Virtual reality meets reality

Almost as healthy as going for a run

ONE trouble with video games is that some children prefer exploring a virtual fantasyland in the comfort of their home to messing around outdoors. Many parents will no doubt be thankful, then, that Konami Computer Entertainment, a Japanese game developer, has come up with an idea to get kids out in the sun. While the player hunts vampires in the virtual world, a solar sensor picks up sunlight that helps him to slay more of the bloodsucking enemy.

The game, which Konami started to ship to America last week, has been selling in Japan for a couple of months. The Japanese name, “Bokura no Taiyo”, means “Our Sun”. Konami has shortened the name to Boktai for the American version, however, and given it a suitably individualistic tagline: “The sun is in your hand”.

The game is made for Nintendo's Game Boy, a handheld console that is easy to take outside. The solar sensor is built into the game cartridge, which juts out of the device, but it does not actually supply the device with power. Instead, the solar sensor's role is to sway the fortunes of the vampire-hunting hero, Django (“heir of the solar gun”), and Master Otenko, his sunflower sidekick. Try as they may, the two of them cannot defeat their mortal enemies unless their virtual power has been boosted by the actual sun's rays.

This innovation is the brainchild of Hideo Kojima, a developer who was keen to introduce more randomness into the gamer's experience. The amount of sunlight available when the player steps outside is clearly beyond the software writer's control. Mr Kojima is now said to be looking for other ways to make the virtual and real worlds interact—perhaps a game for car passengers in which the cartridge detects the speed and feeds it into the virtual world (which should be a big hit with traffic cops).

Parents will also be pleased to find that Boktai comes with sensible advice. Gamers are urged to use sunblock, wear a hat and drink lots of water before going out to play. Some video junkies will no doubt find this advice both necessary and novel. Konami has also considered other contingencies. The firm decided to delay the game's release in Europe until next spring. The alternative was to release it later this year, says a spokesman, “and we didn't want kids going outside to play the game when it is freezing.”

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The obesity industry

Big business

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Fat profits in fat people?

THE latest accessory for waiters at some restaurants in America is a handheld computer. This is not, as you might expect, to transmit orders instantly via a wireless network to the kitchen for even faster food, but to calculate for customers the amount of fats and carbohydrates in their entrées. As people everywhere get bigger, all manner of businesses are addressing the threat, and opportunity, in what the World Health Organisation calls “globesity”.

Fat is no longer just a problem in America, where nearly one-third of adults are thought to be obese. Millions more are overweight, though not (yet) heavy enough to qualify as obese. There are now an estimated 300m obese adults worldwide, up from 200m in 1995. In a decade or so, even countries not now associated with bulky populations, such as France and Japan, could have a big problem.

The business implications are also enormous. American girls today shop for clothes that are roughly two sizes bigger than those worn by their mothers. Seats in public places such as sports arenas are being made bigger, as are those in aircraft. Drug firms are searching for miracle slimming drugs and the latest dieting fads become best-sellers. After claims that its advice on healthy eating is obsolete, the Bush administration said on September 23rd that it will draw up new guidelines. Expect hard lobbying by food firms fearful that the government's panel of experts may advise against eating their products.

Some food firms have announced plans that could affect the health both of their customers and of their profits. On September 18th, Burger King launched its first product aimed at people watching their waistline: a low-fat chicken sandwich. It hopes to reverse a six-year slide in sales, in part due to competition from chains such as Subway that offer “healthier” alternatives to burgers and fries. McDonald's, having put salads on its menu as part of a global makeover, has signed up Bob Greene, an exercise guru best known as Oprah Winfrey's personal trainer. He will promote a new chicken-based meal called “Go Active” which comes with exercise tips and a clip-on pedometer to encourage customers to walk more. Next year, Kraft Foods, America's biggest food firm, will trim its portion sizes and provide more nutritional information.

How will consumers react? New research shows that most Americans are well aware of the risks of obesity. “But people are not prepared to give up taste as their solution to this problem,” says Gary Epstein of Euro RSCG Tatham Partners, part of an international marketing group. One of the most striking findings of his new study on globesity is that some 90% of American consumers believe they are personally accountable for their weight. Only a few blame fast-food firms. This does not remove the threat of litigation. But it does suggest that most Americans think it was right for a federal court to dismiss a lawsuit from two teenagers who blamed McDonald's for making them fat.

The recent explosion in the popularity of low-carbohydrate slimming methods, such as the Atkins and South Beach diets, and the launch of a host of new low-carb food products, further illustrates that, if firms can come up with easy and tasty ways to lose weight, then people will rush to try them. The Atkins diet, for example, excludes carbohydrates, but allows dieters to stuff themselves with steaks and other fat-rich, protein-rich foods.

Although health officials worry about the long-term effects of such diets, they have had a seismic effect on the slimming business—worth $40 billion in America alone. Attending a “carbo summit” held at the Flour Advisory Bureau in London this week were bakers, potato growers and pasta makers, whose sales have been hit by the popularity of the Atkins diet. Carbo summiteers cheered a specially commissioned review of the scientific literature that concluded—surprise!—that the best way to lose weight is to exercise more, and to eat less fat and more carbohydrates.

“Americans have certainly woken up to the threat of obesity,” adds Mr Epstein's report. Yet he believes that selling people more healthy lifestyles will be difficult. The study confirmed that, despite the very high level of consumer awareness about the problems of being overweight, people struggle to do something practical about it. Crucially, that was even true of so-called “prosumers”, some 20% of his sample. These people tend to be better educated and are of particular interest to marketing experts because, savvy and adventurous, they set purchasing trends. “Consume less, consume better and exercise more isn't about to become a mass-market trend anytime soon,” argues the report.

The obvious conclusion: a growing herd of fat people will provide lots of demand for firms supplying everything from bigger towels to bigger beds and, alas, bigger coffins. Demand for adult-sized electric tricycles may grow as some of the obese find it hard to walk. In health care, much will change. Some hospitals, for instance, are finding some obese people cannot be squeezed into MRI machines for scans.

Drugs firms are targeting fat. Shares in Alizyme, a British biotech firm, soared on September 19th after it said clinical trials showed its new anti-obesity drug to be as good as rival products, but with fewer side effects. Surgery, and eventually genetic manipulation, could become common forms of treatment. Liposuction is but a start. Firms are scrambling to develop additives to make diet foods taste better, including by blocking bitter tastes. Expect the globesity business to grow fast, then, along with its expanding customers.

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The litigation business

Trial Lawyers Inc

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A growth industry

AMERICA'S businessmen tend to regard trial lawyers as the enemy, and complain endlessly about how law firms are profiting at their expense. But, apart from headlines about terrifyingly large awards of punitive damages that are often reduced on appeal, hard facts to support these claims have been notably rare—until now. On September 23rd the Manhattan Institute, a think-tank, published “Trial Lawyers Inc”, a study of America's civil litigation business written, wryly, in the style of a company annual report.

Settlements for tort litigation now exceed $200 billion annually in America. At 2% of GDP, this is far more than in other rich countries, says James Copeland of the Manhattan Institute's Centre for Legal Policy. Of this, Trial Lawyers Inc, America's law firms, take a juicy $40 billion. Their revenue growth has been a remarkable 9% a year over the past three decades, more than the compound growth of the Dow Jones industrial average. Unlike the stockmarket, the plaintiff bar seems to be recession proof. “Most people are aware there are wacky lawsuits and that America has a litigious culture, but they are unaware of how big a business the trial bar has become,” says Mr Copeland.

The annual report also shows how the business is expanding into new areas. Profits from the multibillion dollar tobacco litigation settlement in 1998 have served as seed capital for law firms to invest in developing promising new markets much as venture capitalists fund start-up firms. Trial Lawyers Inc now caters to at least 74 separate product lines. Alongside old favourites such as asbestos and malpractice lawsuits, hot growth markets now include lawsuits over obesity, mobile phones and mould, as well as more speculative innovations such as business disruption litigation on behalf of Hollywood prostitutes “disrupted” by film-production teams. Specialist niche businesses include malfunctioning automatic doors, tap-water burns, and defective gas-cans.

Whether this provides justice for victims, as the lawyers claim, or an obscene burden on corporate America, or a bit of both, there seems to be no stopping the modern, money-driven litigation business. Gone are the days when law students were expected to absorb lofty sentiments such as the one uttered by Roscoe Pound, a former dean of Harvard's law school: “The professional man does not measure out his service in proportion to reward.” Now, many law-school professors are highly-paid consultants for litigating lawyers. Even The Roscoe Pound Centre is, the report notes, funded by trial lawyers.

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Face value

Germany's fat cats on trial

Sep 25th 2003
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What does the prosecution of Josef Ackermann reveal about German corporate governance?

ROPI

JOSEF ACKERMANN, the normally unflappable boss of Deutsche Bank, faced a barrage of questions at last weekend's IMF/World Bank meetings in Dubai—but not about the stability of the global financial system. His role as chairman of the prestigious Institute of International Finance was of rather less interest than the decision by a criminal court in Dusseldorf to try him and five others on charges of breaking German securities law.

The charges relate to the hugely controversial hostile takeover in February 2000 of Mannesmann, a German conglomerate, by Vodafone, a British mobile-phone company. When Mannesmann's management board capitulated, some of its executives (past and present) were paid bonuses totalling *euro*57m ($53m). Mr Ackermann sat on Mannesmann's supervisory board—which, under Germany's two-tier board system, oversees the management board that runs the firm—and the compensation committee that approved the payments. Paragraph 87 of Germany's securities law says that such awards to board members should bear a “reasonable relationship to their duties”.

Payments of millions of dollars are familiar fare in Mr Ackermann's investment-banking industry, if less so in mainstream corporate Germany. Deutsche, Germany's biggest bank, paid $100m to Frank Newman in 1999 when his services were no longer required as boss of its newly-acquired American subsidiary, Bankers Trust. A year earlier, Deutsche also paid millions to Frank Quattrone, head of its corporate finance boutique in California, just to be rid of him—probably money well spent given the havoc Mr Quattrone later wreaked at CSFB, the investment-banking arm of Credit Suisse. So a few million euros spread among the top executives of Mannesmann may have seemed no big deal. But Binz & Partner, a Stuttgart law firm, thought otherwise. In February 2000 it alerted prosecutors in Dusseldorf, Mannesmann's home town. It believed that the payments represented an Anglo-Saxon “help-yourself” mentality that was invading Germany. Last week the court decided to let the case go to trial. Mr Ackermann and two others are charged with *Untreue*—“breach of trust”. Klaus Esser, Mannesmann's then boss, and two colleagues are charged with being accessories.

Because of an incidental decision in a supervisory board role that he never wanted, Mr Ackermann's career could come to an abrupt end. Shareholder groups have called for him to stand down to fight the charges, though he seems inclined to remain at the helm of Deutsche, which he joined in 1996 from Credit Suisse. (With him in charge at Deutsche, a merger with Credit Suisse is no longer unthinkable.) The trial will probably not start until next year. Mr Ackermann would have to appear in Dusseldorf, where he already has an office, for at most one or two days a week, leaving him time to run the bank. He is unlikely to settle out of court. Deutsche might pay good money to save its star from a high-profile trial. But a settlement, possibly with a payment to a good cause, would not clear Mr Ackermann's name.

There is some irony in Mr Ackermann's branding as a symbol of greedy American-style capitalism, for there is no suggestion that his alleged crime in any way enriched him. At worst, he may have agreed to spread largesse more casually than others would have done. Yet in other respects he does represent a shift in the direction of American capitalism. He did go along with the sale of Mannesmann; hostile takeovers were hitherto regarded with horror in Germany. He was the prime mover behind making the top management job at Deutsche much more like that of an American chief executive by establishing a global executive committee—alongside its formal two-tier board—that is now the real power at the bank. He is presiding over the reduction of Deutsche's big shareholdings in German firms, stakes that are the

hallmark of that country's approach to capitalism. A Swiss interloper, he has even dared to criticise Germany's failure to make the structural reforms its economy so badly needs. In January, he gave warning that Germany could become the “next Japan”. His presence provides a much needed breath of fresh air into the stuffy upper reaches of corporate Germany. It would be a pity to lose him.

A fine balance

Yet whether the trial is good or bad for corporate Germany is the subject of intense debate, inside and outside the country. There are those who think the charges are trumped-up nonsense driven by envy and pinko politics. (North Rhine Westphalia is a Social Democrat stronghold: this, says the nonsense camp, would never have happened in Bavaria, where the local conservative party has just won state elections by a wide margin.) Angela Merkel, leader of the main conservative party outside Bavaria, claimed, as Mr Ackermann himself has done, that the case will damage the confidence of foreign investors. Rumours have resurfaced that, in protest, Deutsche will relocate its headquarters to London—where it already does much of its most lucrative business. The bank has denied this many times.

Others believe that the law must be upheld, however petty it may seem and however casual the infringement. After all, prosecutors have even pursued bosses in super-capitalist America. Why not show that Germany, too, is making a stand against fat-cattery? And it remains to be seen how serious the charges are. Discretionary payments by boards to executives often carry with them a nasty smell; in this case, there is an unfortunate-looking coincidence, at the very least, of the timing of the bonuses and the decision by Mr Esser to abandon his hitherto fierce opposition to the Vodafone deal. Still, the rest of corporate Germany seems to have learned something from all this. By all accounts, since prosecutors started to pursue Binz's accusations, supervisory boards have been taking their monitoring role much more seriously. Every cloud has a silver lining.

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State pensions in Europe

The crumbling pillars of old age

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If governments and employers cannot be trusted to provide for old age, who can?

Get article background

ON TUESDAY September 23rd, Silvio Berlusconi, the prime minister of Italy, briefed employers and union leaders on a long-anticipated plan to reform his country's state pension system. It is in dire need of reform. Italy has one of the lowest birth rates in the world and one of the most generous state pension schemes—an unsustainable combination that leaves an ever diminishing workforce paying for an ever rising number of pensioners. Many other countries in Europe are saddled with similar problems, largely based on promises made before the workers who will pay for them were even born.

The Bank of Italy and Confindustria, the employers' association, say (rightly) that Mr Berlusconi's package does not go nearly far enough. However, Italy's three main unions, the CGIL, UIL and CISL, think it goes too far. They have threatened “a fighting response...a strike.”

If the package survives future labour unrest, it will at least have taken some steps in the right direction. For example, it proposes that from 2008 the mandatory retirement age be raised from 60 to 65, and that the minimum number of years to be spent in employment in order to qualify for a full state pension be lifted from 35 to 40. It also proposes scrapping the so-called seniority pensions that allow Italians to retire at 57 if they have worked for 35 years. The proposal is due to be approved by the Italian cabinet on September 29th before being submitted to parliament.

Attempts to trim state pensions in recent years have aroused the anger of workers across Europe. On June 3rd this year France was virtually closed by a nationwide strike against the government's proposed pension changes, on the same day that Austrians brought their country to a halt over pension reform. Normally a model of cosily consensual industrial relations, Austria saw more than a million people take to the streets to demonstrate their grievances over pensions.

In France and Italy, political leaders have repeatedly backed down when strikes over pension reform have threatened to paralyse their countries. In 1995 the then French prime minister, Alain Juppé, lost his job over the issue. Leaders in Austria, Germany and Spain have avoided strikes largely by avoiding serious attempts at reform, muddling through in the meantime with timid tinkering that does not touch the fundamentals.

This year, however, has been significantly different. The French prime minister, Jean-Pierre Raffarin,

claiming grandiloquently that the pensions issue was “about the survival of the republic”, pushed through unpopular reforms and managed to keep his job. So too did Wolfgang Schüssel, his Austrian counterpart.

Gerhard Schröder, the German chancellor, has not yet taken steps as radical as his two neighbours', but he may soon have to do so. On August 29th, an advisory panel recommended that he gradually cut pension payments by as much as 10% in real terms over the coming years, and that he progressively raise the retirement age from 65 to 67.

You pay as they go

Europe's state-administered pension systems are, for the most part, financed on a pay-as-you-go (PAYG) basis. There is no huge pot out of which future obligations can be met. Those in work pay (via a tax on their current wages) for the pensions of those who have retired. In Italy and Austria, public pensions gobble up as much as 15% of GDP annually; in France and Germany the figure is about 12%. By 2040, says Commerzbank, a German bank, some governments' overall unfunded pension liabilities will be three times their country's GDP, if nothing is done before then. The bank goes on to say that the PAYG schemes underlying most state pensions would see their practitioners thrown in jail if they were private operations.

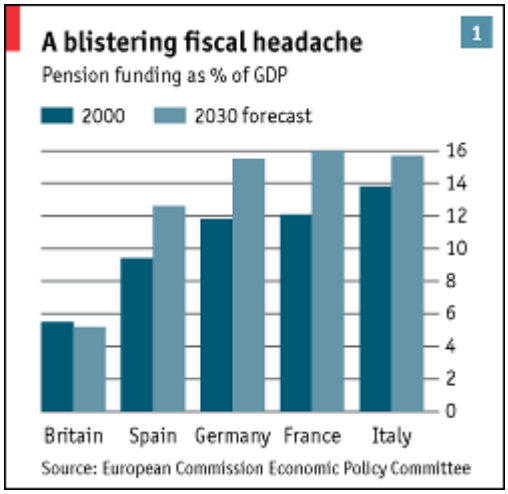
The outlook for state pensions is not equally dire across Europe. Britain, the Netherlands, Scandinavia and Switzerland, for example, have already shifted much of their pension burden from what is known as the first pillar (the state) to the second pillar (the employer), and even in places to the third pillar (the individual pensioner-to-be). In Britain and America, government spending on pensions accounts for only 5-6% of GDP a year.

Pay-as-you-go systems were introduced as long ago as 1889 by Otto von Bismarck, Germany's chancellor. They worked well for as long as the active workforce vastly outnumbered the retirees—as they did in Bismarck's day. The retirement age then was 70, and the average life expectancy was 48.

But life expectancy has been rising now for 300 years, and it rose particularly quickly in the second half of the 20th century. Between 1950 and 1995, average life expectancy in Britain increased from 69.2 years to 76.2, and in France from 66.5 to 77.1. Moreover, it has not stopped rising yet. Between 2000 and 2020 the remaining life expectancy of a 65-year-old male in Germany is expected to increase from 12.1 years to 14.9.

This ageing of the population is being combined with falling birth rates, a relatively new phenomenon. During the baby boom of the 1960s—between 1960 and 1965—the overall birth rate in the European Union was 2.7 children per woman, comfortably above the rate of 2.1 required to maintain the size of the population. By 1995, however, that rate had fallen dramatically to 1.5 children per woman. In Italy, the figure is even lower. In a paper published this week, David Willetts, the British Conservative Party's spokesman on pensions, wrote that Europe's pension problem “is not life expectancy. It is birth rates. Europe's working-age population is set to fall by 40m, or 18%, by 2050.”

Low birth rates are an old-world phenomenon. America has a much higher birth rate and a higher rate of immigration. (Immigration, however, does not boost populations as much as is sometimes assumed, because immigrants tend to have few children in their new country.) At the moment, the EU's population is some 90m greater than America's. But by 2050 America could have 40-60m more people than today's EU member states.



Germany and Austria illustrate the remorseless consequences of this demographic pincer movement. Seven-tenths of Germans' pensions still come from the Bismarckian state system. Last year the levy on wages to pay for this, half of it from workers and half from employers, was 19.1%. Today, fewer than three workers support each German pensioner. But if current ageing and fertility trends continue, that figure could be halved by 2030.

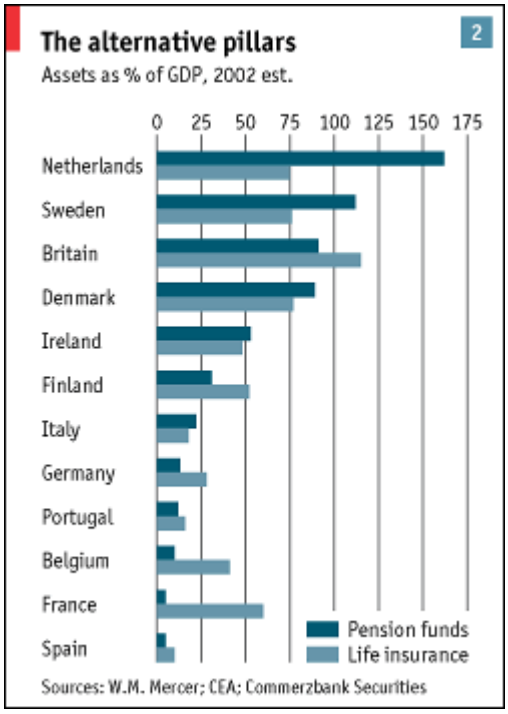
In Austria, had Mr Schüssel not fought for his government's reform, workers would have been obliged to channel almost half of their wages into the state pension scheme in 20 years. Under those circumstances, any Austrian with portable skills would almost certainly choose to take them elsewhere.

Pretend it's painless

As the pension time-bomb has ticked away, European governments have become more imaginative in finding methods to cut back on the promises of the state pension system. Their main aim has been to make the cuts seem as painless as possible, and to encourage people to save on their own for their retirement.

Governments are, for instance, prolonging the number of years that a person has to work in order to qualify for a full state pension. This is proving to be one of the least unpopular reforms—people are more unhappy about increases in contributions or cutbacks in benefits—except in France. There the increase in the number of years that public-sector employees must work in order to qualify for a pension (from 37.5 to 40, and later to 42, the same as the requirement in the private sector) was the most controversial part of this year's reform bill.

Another step that is being taken in order to ease the pressure on state pensions is to switch any indexation of the benefits from wage inflation to price inflation. France was one of the first to do this (in 1993), but the reform applied only to the private sector. As wages tend to rise by more than prices, the move was inevitably accompanied by a rush *aux barricades.*



A more simple reform is to raise the retirement age. This year Austria decided to increase its retirement age for men gradually from 61.5 to 65 years, and for women from 56.5 to 60 years. Italy is now planning to raise its retirement age to 65—though Giancarlo Fontanelli of Inpdap, the social-security agency for public-sector workers, would like 70 to be the retirement age for everyone. And Germany, which has already raised its retirement age from 63 to 65, may yet go further. Bert Rürup, an economist on Mr Schröder's advisory panel, is proposing it be raised in monthly increments to 67 between 2011 and 2035.

Putting more in the pot

As the extent of the pensions crisis began to unfold, a number of countries set up reserve or buffer funds to help them pay the bills. The earliest funds were created in the 1960s and 1970s in America, Canada and Japan, but they were designed as a safeguard for the social-security system as a whole, not specifically for pensions. The funds set up by Belgium, France and Ireland over the past decade, on the other hand, were specifically intended to back their PAYG schemes.

The French buffer fund, the Fonds de Réserve pour les Retraites (FRR), was set up in 1999 with the aim of raising as much as €150 billion ($172 billion) by 2020 to help finance public pensions for the following ten years. September 12th this year was the closing date for applications from private-sector firms to manage the 27 separate pools into which the €16.6 billion that the FRR has so far managed to accumulate has been divided. There was no shortage of candidates for the jobs.

Governments in Europe have also tried to encourage their citizens to save for themselves by sweetening new individual savings schemes with tax breaks. In 2001, for example, Sweden allowed its workers to put 2.5% of their wages (out of their 18.5% payroll-tax contribution) into an individual account.

In the same year, Germany introduced the Riester pension, named after Walter Riester, the labour minister responsible for the reform. This gives German workers the option of putting 1% of their pay into their own retirement account, a percentage that is to rise in steps to 4% by 2008. The Riester scheme has failed to take off as planned, though, despite generous subsidies to encourage low-earners and parents with dependent children to take part. Some say the scheme is too hard to understand; others claim that savers are still too scarred by the recent bear market.

Occasionally governments are more blunt. Either they increase the mandatory contributions to the pensions scheme—in 1997, for example, the Netherlands increased the pensions levy on wages from

15.4% to 18.25%, and Finland introduced an employee contribution in addition to the existing employer's contribution in 1993—or they reduce the pension benefits, a move as detested as any increase in the tax. In Austria, for example, benefits for new pensioners will be cut by 13.5% next year, and Austrians retiring early will suffer cutbacks in their pension benefits.

The corporate option

European governments hoping that corporations will solve the pensions crisis for them will be disappointed. The problems experienced by American and British companies' pension funds in recent years are a stark warning to countries trying to make the switch from public- to private-sector pension provision.

Most American and British companies' employee pension funds were set up as defined-benefit schemes, schemes that promise to pay a given pension at a given age. This left the companies to assume the risk if the funds' returns proved insufficient to meet those defined obligations. And sure enough, after the prolonged bear market, huge holes have been appearing in companies' pension funds. Not surprisingly, companies have been scrambling to convert their existing pension plans into so-called defined-contribution schemes, where the full pension cost is predictable.

Even so, some 44m Americans are still covered by defined-benefit plans, and American companies' pension funds now have a combined deficit (the amount by which the value of the scheme's assets falls short of the current value of the pensions they are pledged to pay in future) of about $400 billion. Many firms have started to make large contributions to bridge some of the gap and to satisfy statutory requirements. Last year, for example, they pumped $31.6 billion into their pension funds. This year they would have had to pay an estimated $125 billion in top-ups if the rules on pension-fund solvency had not been relaxed.

Pension obligations have become a huge drag on corporate earnings and, as such, they are threatening the American economy's timid recovery. Two bills currently in Congress are seeking to provide relief while still maintaining the health of corporate pension funds. On September 17th, the Senate's finance committee voted to give companies some relief on their pension funding, a move that could save them about $60 billion over the next three years. A bill introduced by Republicans in the House of Representatives would save them only about $25.5 billion over the next two years.

The Confederation of British Industry puts the shortfall in British corporate pension funds at £160 billion ($265 billion). Companies such as Sainsbury's, Marks & Spencer, HSBC, BT and GlaxoSmithKline are closing their defined-benefit schemes to new employees and replacing them with defined-contribution plans. This switch has cost British employees up to £1.6 billion a year in pension payments, according to Close Wealth Management, an investment manager. About 900,000 people have seen their defined-benefit plans closed down and their employers substantially reduce their contribution to the alternative (defined-contribution) plan, sometimes by as much as half.

Funding for yourself

With the expansion of defined-contribution plans, which lumber the individual with the investment risk of his or her pension, the distinction between the second and third pillars of support is blurring. So it makes more sense for people to organise their own pension plans instead of leaving them up to an employer, with whom they are less and less likely to remain for the whole of their working life. What's more, with an individual private retirement account people are free to decide for themselves when to stop working. Every extra year of work increases their pension pot.

So Europe should look to Latin American countries, which pioneered this do-it-yourself approach by introducing individual retirement savings accounts. In 1980, Chile set up a funded scheme to replace the country's bankrupt PAYG system. The scheme requires workers to pay 10% of their annual income into private retirement accounts, which they own and control. About 5.6m Chileans are contributing to the scheme, although it is compulsory only for the 3m of the country's workforce who are in full-time employment.

Other Latin American countries have introduced similar, though less comprehensive reforms. Mexico, for instance, introduced obligatory, privately managed retirement-savings accounts for its private-sector

workers in 1997. Bolivia, one of the poorest countries in the region, replaced its state pension system in 1997 with private retirement savings accounts. Bolivians, like Chileans, now pay 10% of their wages into this pension scheme. El Salvador introduced a system very similar to the Chilean model in 1998, and Colombia, Argentina and Uruguay have also partially privatised their systems.

If private contributions to retirement savings accounts are not mandatory, as they are in Latin America, there is concern that, left to their own devices, individuals may not save enough for their old age. The Association of British Insurers warns that there is a £27 billion gap between what people in Britain are saving and what is needed for them to enjoy a comfortable retirement. (About one-third of Britons are not saving anything at all, while a good part of the rest save for holidays or cars but not for their long-term welfare.)

One solution is to introduce an element or two of compulsion. In Britain, for instance, the government could make its stakeholder pensions, a new low-charge private investment scheme, compulsory for all employees. Likewise, Germany's Riester pension could become mandatory for employees there.

Of course, the transition from the first to the third pillar cannot happen overnight. The longer a PAYG pension system has been going, and the more generous its benefits, the bigger the build-up of implicit debt in the system. Because of this heavy transitional burden, no country with a large PAYG scheme can make a rapid switch to a privatised alternative. For one thing, that would impose a double burden on the current working generation. They would have to build up their own funded pension at the same time as they pay today's pensioners for previous governments' promises.

When younger members of the workforce feel the full weight of the burden they are being expected to carry, they may start to protest, and so provide a political counterweight to the ageing voters who are determined to protect their own entitlements at the expense of those coming after them. Alternatively, of course, younger people could remove the need to fund a pension for themselves by returning to the oldest pension plan on the planet—a large number of children. That, of course, would solve the birth-rate problem too.

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Currencies

A-a-and down!

Sep 25th 2003
From The Economist print edition

Alamy

Expect the dollar to slide further after this week's sharp decline

Get article background

STATEMENTS by the finance ministers and central bankers of the Group of Seven (G7) rich industrial economies are usually rather bland. This makes it easier for member countries to agree to them, and it avoids unsettling financial markets. However, the G7 statement issued on September 20th in Dubai, ahead of the annual meetings of the IMF and the World Bank, was of a spicier type. Its call for “more flexibility” in exchange rates took markets completely by surprise, pushing the dollar sharply lower. It is therefore awkward that finance ministers seem to disagree about exactly what they meant.

John Snow, America's treasury secretary, proclaimed the statement to be “a milestone change”. The currency markets listened. They interpreted the communiqué as telling the Japanese and the Chinese to let their currencies rise and thus to allow the dollar to fall. Japan has been holding down the yen through foreign-exchange intervention on a grand scale; the Chinese yuan is pegged to the dollar with the help of strict capital controls.

However, Japanese and British officials quickly denied that this marked any change in policy. To add to the confusion, two days later Mr Snow said there had been no change in America's “strong dollar policy”. Currency markets, however, stuck by their initial interpretation. By September 23rd, the dollar had fallen to a three-year low of less than ¥111, before stabilising. It had shed 5% in little more than a week. The dollar also gave up most of its recent gains against the euro, falling back to a rate of $1.15.

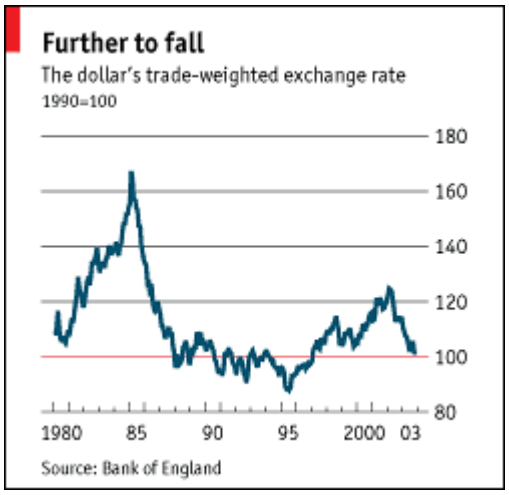
This resumes the steady slide in the dollar that began in early 2002. Over the past few months, evidence of a stronger recovery in America had pushed the dollar higher. But just as some economists had started to predict that the dollar could rise back to parity against the euro, currency markets have now switched their attention from growth rates to America's huge current-account deficit. If America's economy does grow faster than those of its main trading partners, then its external deficit will also widen by more.

The sharp fall in the dollar caused stockmarkets to shudder. Investors fretted about a loss of export competitiveness in Japan and Europe: the Nikkei fell by 5% during the week, Germany's DAX by 7%. Wall Street also slipped: although a weak dollar should be good for American profits and hence share prices, investors worried that bond yields will rise sharply if Asian central banks stop intervening and so buy fewer American Treasury bonds.

The buck doesn't stop here

The Dubai statement was certainly not another Plaza Accord. In 1985, after the dollar had soared, G7 finance ministers agreed at a meeting in New York to intervene together to push down the greenback. This time, not only is there less agreement, but the authorities are leaving adjustment to the markets. Nevertheless, says Stephen Roach, the chief economist at Morgan Stanley, the G7 have sent out a clear message that a dangerously unbalanced world needs a weaker dollar. It would help to shift the balance of American growth from consumer demand to exports, allowing households to rebuild their savings and slimming America's current-account deficit. In Europe and Japan, a weaker dollar would cramp exports, but that could, in theory, be offset by looser monetary or fiscal policies to boost domestic demand.

The euro has already risen by around 35% against the dollar over the past couple of years, while the yen has risen more modestly thanks to heavy intervention. Earlier this year, when Japan's economy looked sickly and deflation seemed to be worsening, there were good reasons for Japan to hold down the yen. But the case for intervention has perhaps weakened. Japan's GDP grew by 3% in the year to the second quarter, the strongest growth in any G7 economy. Many economists think the true rate may be a bit lower. Still, even nominal GDP grew in the second quarter.



Either way, Japan's economy is much stronger than the market had expected. For example, in June J.P. Morgan Chase forecast that Japan's GDP would grow by an average of only 0.8% this year and next; now it is betting on average growth of 2.7%. Its growth predictions for America have been raised by much less. If (still a big if) such forecasts prove correct, then the recent rise in the yen would be justified.

Has Japan really caved in to demands that it cease holding down its currency? No. The yen's recent rise reflects a change in the market's perception of Japan's prospects, not a change in the country's policy. Sadakazu Tanigaki, the new finance minister, spoke this week of the dangers of the yen rising further. If it does continue to climb, the ministry may intervene again.

Meanwhile the American government is likely to keep up its criticism of China. Although America's economy has picked up this year, employment has continued to shrink. This is why the dollar has become such a hot political issue. Exporters blame the cheap yuan for America's large trade deficit. However, Chinese officials were quick to dismiss the communiqué from the G7 (of which China is not a member), making clear that they had no intention of revaluing the yuan soon.

The pegging of the yuan and other Asian currencies to the dollar means that the dollar has fallen by much less in trade-weighted terms than against the euro. The dollar has fallen by 19% against a basket of other rich countries' currencies (the measure used in the indicators published each week in our back pages), but by only 10% against a broader basket which also includes emerging-market currencies.

That 19% decline in the narrower trade-weighted index pales next to the 40% drop in the three years after 1985. America's current-account deficit was then only around 3% of GDP, half as big as it is likely to be by next year. A further decline in the dollar seems all but inevitable.

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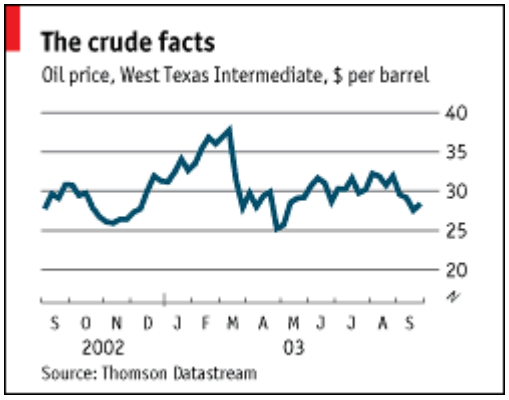
Oil prices

Another pre-emptive strike

Sep 25th 2003
From The Economist print edition

Why did OPEC chop its quotas?



AT CERTAIN tense moments, gatherings of the Organisation of Petroleum Exporting Countries (OPEC) produce high drama. However, the gathering of OPEC ministers in Vienna on September 24th was expected to be a quiet formality.

Various countries had indicated that no change in quotas was likely. Prices had softened in the run-up to the meeting, but the cartel's crude oil still traded well within the band of $22 to $28 that OPEC has set as its target. Álvaro Silva, the group's Venezuelan secretary-general, had declared supplies adequate. Indeed, the only theatrics seemed likely to surround comments made by Mr Silva's Venezuelan boss, President Hugo Chávez, that it was wrong to invite Iraq's interim oil minister because he was an illegitimate stooge for the Americans.

In the event, oil ministers agreed to cut production by 900,000 barrels per day from November 1st. More significantly, they made it clear that they stood ready to cut output quickly again if they had to. They agreed to meet on December 4th to reassess the situation. The move caught many traders by surprise, and led to a frenzy on the New York Mercantile Exchange that sent crude oil futures up by some 5% on the day of the meeting. Stockmarkets, already rattled by a declining dollar, fell: traders worried that higher oil prices might slow global economic recovery.

Why did they do it? The recent fall in oil prices played a part, of course, as did the growing inventories of petroleum in the rich world. Ironically, though, the biggest factor may well have been Iraq's controversial presence. Iraq is considered irrelevant for now because its oil sector is in a shambles. Thanks to recent sabotage, it has been exporting far less than half its OPEC quota. Yet Iraq's oil minister seems to have persuaded his new friends that his country's exports are set to surge—perhaps even to double within a few months.

Many experts treat Iraqi claims of a swift revival with suspicion, but it seems the cartel's ministers do not. They fear that a sudden surge of Iraqi oil could lead to an oil-price collapse of the sort seen five years ago, when oil prices fell almost to $10 a barrel. That is why, as Michael Rothman of Merrill Lynch puts it, “they've decided to launch a pre-emptive strike on Iraq.”

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Investment banks

Fleet of foot

Sep 25th 2003
From The Economist print edition

How did investment banks beat the turmoil in the Treasury-bond market?

PAIN had been widely predicted for investment banks this week. In the past couple of years, they have made much of their profits in booming bond markets. Yet in the past quarter the Treasury market was sold off sharply and became more volatile than ever before. So it seemed likely that investment banks' third-quarter results—covering June, July and August—would make sorry reading. Happily, it was not to be. Defying all past form as well as expectations, it seems that the banks managed their risks well.

Three of Wall Street's finest reported their third-quarter results on September 23rd. Those of one, Goldman Sachs, were merely respectable. Those of the others, Morgan Stanley and Lehman Brothers, were impressive. This had something to do with a pick-up in business outside the bond markets. However, it had much more to do with the banks' fleet-footedness.

Goldman, widely viewed on Wall Street as a hedge fund with an investment-banking business attached, suffered most from the bond-market rout. It made $677m in the quarter, up some 30% on the year, despite having been on the wrong side of a big trade in mortgage-backed securities. But Morgan Stanley and Lehman Brothers more than doubled their profits on a year earlier, to $1.3 billion and $480m respectively. Although a big chunk of the increase in profits at Morgan Stanley came from a change in the way in which the firm treats stock options, much of the profit made by both investment banks came from bond trading.

Investors have long worried about investment banks making money by trading for their own account—so-called proprietary trading—because they are unlikely to win consistently. Therefore banks have often rechristened proprietary trading “customer flows”. Because the profit comes almost entirely from holding a position, not from making a turn on the difference between buying and selling prices, the change of name makes little practical difference. Whatever they call it, banks did well in a difficult market.

One reason for this, perhaps, is that they saw the bond-market rout coming and positioned themselves accordingly—ie, sold Treasuries short. Another is that their traders took the advice of their risk managers, and switched from Treasuries to corporate bonds. According to RiskMetrics, a research firm, in July Treasury bonds were, believe it or not, riskier than junk bonds for the first time ever.

This surely seems counterintuitive. However, it was the conclusion thrown up by the risk-management model used by RiskMetrics and big banks and their regulators across the globe for their trading operations, which is called Value-at-Risk (VaR). In essence, this model looks at the volatility of all the assets in a portfolio and the relationship between them.

From July onwards, two things happened. First, Treasuries became more volatile than ever before. Second, equity-market volatility fell dramatically. Since the value of corporate bonds, especially junk bonds, depends far more on what happens to equity prices than to Treasuries, a portfolio of junk looked safer than a portfolio of Treasuries.

Investment banks' risk-management departments spotted this and advised accordingly. As any bank's management will tell you, VaR models have done poorly in past crises. This time they worked. Treasuries continued to fall sharply, but junk bonds, in particular, prospered.

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About sponsorship

The New York Stock Exchange

Thin Reed

Sep 25th 2003 | NEW YORK
From The Economist print edition

An odd choice for the temporary head of the New York Stock Exchange

Reuters

Reed to the rescue

BEING in the right place at the right time is a difficult art—especially when the right place is a long way from the limelight. John Reed, former chief executive of Citibank, seems to have the knack. With his reputation burnished by three years of retirement, he has emerged as the temporary head of the embattled New York Stock Exchange (NYSE).

Mr Reed's emergency appointment, announced on September 21st, has been greeted with applause. His salary, $1, is noteworthy, given that his predecessor, Richard Grasso, was brought down by his acceptance of a $140m pay packet. Mr Reed's qualifications, according to the search committee, begin with his managerial experience (he ran the world's largest bank), familiarity with international capital markets (he ran the world's most global bank) and his standing as a leader of people. He is also “a statesman”, no less, and has “tremendous grounding in technology”. He was also praised for his “independence”: as a commercial, not investment, banker, the law kept him clear of the NYSE until near the end of his career.

Yet perhaps Mr Reed's best qualification was unspoken. He is the Anti-Sandy. In 2000 Sandy Weill, his co-chief executive at Citi, tossed him out of the bank. Last year, while Citi was negotiating a settlement with Eliot Spitzer, attorney-general of New York state, and other regulators over charges that the bank, along with other Wall Street institutions, hoodwinked investors in the bubble years, Mr Weill was appointed as a public representative to the NYSE's board. With hindsight, this now looks like one of the first mis-steps that led to Mr Grasso's fall.

Mr Reed is due to start work on September 29th—the day before Mr Weill finally steps down as Citi's chief executive. Unlike Mr Weill, who will hang around as his bank's chairman for a couple of years, Mr Reed has promised to move on quickly, possibly within a few months. In retrospect, Mr Weill's desire to stay at Citi has done his reputation little good. Mr Reed managed to depart just before scandal broke over Wall Street, yet most of the practices that caught Mr Spitzer's attention were already going on (even if they primarily affected Mr Weill's side of the bank, not Mr Reed's).

Although Citi enjoyed a spectacular run under Mr Reed during the economic boom of the 1990s, the steepness of its ascent was partly a rebound from the near-ruin of the firm in the 1980s, also under his leadership. Funnily enough, he mused about moving with a small team of senior executives from New York, home of Citi as well as the NYSE, to Palo Alto or Boston to escape the city's focus on financial markets. His interest in technology is plain—witness his use of automated teller machines to revolutionise American retail banking—yet it also led Citi to a series of costly internet investments that were quickly gutted after his departure. Citi also did not make much out of data supply, a prime NYSE product, despite such acquisitions as Quotron, a stock-quote service.

Although he will be watching over traders, Mr Reed has never been much of a trader himself. As a top commercial banker, he pondered many deals but made few, and none with much success—except the merger with Mr Weill's Travelers Group that led eventually to his own exit. Almost anything he said or wrote was worthy of attention, but he was a quiet figure in an era of vocal chief executives. Often his remarks, like the one about leaving New York, had to be “clarified” by a spokesman. The troubled exchange will need its new boss, even if he is a temporary one, to speak plainly and without need of interpretation.

If Mr Reed is such a curious choice, why pick him? One possibility is that the ranks of the great and good from which emergency executives are drawn have been thinned by the financial industry's recent upheavals. Mr Reed, having been turfed out of Citi, was available and may want to redeem his reputation as a leader. The NYSE's board needed someone with bags of experience in finance. If it has erred, it would not be for the first time.

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Retail banking in Japan

At your service

Sep 25th 2003 | TOKYO
From The Economist print edition

Banks are starting to treat customers decently. Revolutionary stuff

AS ONE Japanese banker joked recently, for years his industry has followed a strategy of “inconvenience banking”. After several big mergers, banks have closed hundreds of branches. To withdraw cash after hours, most banks' customers must pay at least ¥210 ($1.88) to use a cash dispenser in, say, their local Seven-Eleven store. New charges have been introduced for basic services, such as using cash dispensers on Saturdays. The Bank of Tokyo-Mitsubishi charges ¥200 for heavy use of machines that exchange notes (or big coins) for smaller denominations.

Now, though, it seems that banks have decided that it might pay to be nice after all. On September 24th UFJ became the first big bank to start operating cash dispensers 24 hours a day. Its customers will pay ¥105 per after-hours withdrawal. As part of a new retail strategy, costing ¥2 billion a year, the bank, Japan's fourth-biggest, is to keep one-third of its 6,000 dispensers running round the clock. It also plans to start 24-hour telephone banking later this year. Apart from UFJ, only America's Citibank, Shinsei Bank (once nationalised, now owned by Ripplewood Holdings, an American private-equity firm) and a few small regional banks run their dispensers all day and all night.

Customers in other countries, used to free 24-hour banking, may wonder that Japan is so far behind. Yet UFJ's efforts are a sign that banks are at last starting to treat their retail customers seriously. There are several reasons for this. Banks are resting a little easier than they were a few months ago. Stockmarkets have been rising and the banks themselves have made a small dent in their mountain of bad debts. So at last they feel that they can give some attention to developing their businesses. New initiatives by more adventurous banks—such as Shinsei, which lets its customers use its dispensers and those of other banks for nothing—is prodding others to respond. Since launching PowerFlex, a customer-friendly account, two years ago, Shinsei has won 370,000 new accounts.

Banks have also twigged that retail customers are not merely a source of cheap funding, but also a potential source of profits. They have been targeting the mortgage market since the announcement in December 2001 that the state-run, state-subsidised Housing Loan Corporation, which has undercut them for decades, would be wound up by 2005. In the three months to June 30th SMBC, Japan's second-biggest bank, lent ¥430 billion for new mortgages, 70% more than a year before. Another winner, says Hironari Nozaki of HSBC Securities in Tokyo, has been the Bank of Tokyo-Mitsubishi, which has been offering cheap, fixed-rate mortgages.

Not all the banks' new ideas are cuddly. Some are trying to weed out “non-performing” deposit accounts by charging a fee when balances fall below a certain level. One reason Japanese banks have found it hard to make money from retail operations is that they carry masses of dormant accounts (about half of the total, estimates Mr Nozaki). So it makes sense to encourage customers to close these accounts or to use them, and so generate fee-earning transactions for the bank. Wouldn't that be convenient?

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A Hungarian scandal

Attila the stockbroker

Sep 25th 2003 | BUDAPEST
From The Economist print edition

An alleged huge fraud hits one of Hungary's top financial firms

IT MAY be less than one man's pay on Wall Street, but in Hungary forty or fifty million dollars can still go a long way. Quite how far it can go, and into whose pockets, are matters for those investigating a complicated alleged fraud at K&H Equities, the stockbroking arm of the country's second-biggest bank, K&H Bank.

The man at the centre of the scandal, a stockbroker called Attila Kulcsar, is in Austria facing extradition proceedings. The former chief executive of K&H Bank, Tibor Rejto, was arrested earlier this month. Hungarian police have also detained one of two Syrian businessmen, whom they believe—according to media reports—to have received 6 billion forints (about $27m) in cash drained from K&H Equities.

K&H Bank is owned jointly by KBC of Belgium and ABN Amro of the Netherlands. The two foreign banks have promised to make good any bona fide losses to clients. K&H says that only 60 or 70 companies and wealthy private individuals have been “affected by the irregularities”, out of more than 3,000 clients at K&H Equities. Outsiders guess that the alleged fraud could end up costing at least $40m-50m, perhaps more. K&H has yet to give a figure. It expects to do so soon, but wants first to pursue negotiations on some disputed claims.

The bank has said that all the questionable transactions relate to the clients of a single investment adviser. Others say this adviser maintained a “VIP list” of favoured clients. It is alleged that he or others developed a double book-keeping system to conceal some dealings in these accounts, issuing clients with documents showing fictitious receipts and balances, and that under cover of this system money was siphoned away.

Wherever it ended up, which is still not clear, investigators believe that much of it was helped on its way by the two Syrians. These men collected large sums in cash, which they say was legitimately theirs, via accounts held at another Hungarian bank, Inter-Europa, between May 2000 and June this year.

Fidesz, Hungary's main opposition party, has been quick to point out that this and other details give the scandal a strong political flavour, and is doing its best to embarrass the government. Peter Medgyessy, Hungary's socialist prime minister since May 2002, was chairman of Inter-Europa until September 2001. His finance minister, Csaba Laszlo, was previously a director of K&H Bank.

Fidesz calls the affair “the biggest scandal that has ever rocked Hungarian politics since the fall of communism”. The party accuses the Socialists of “hindering” parliamentary investigation of the affair, and of pursuing a vendetta against Hungary's top financial regulator, Karoly Szasz, head of the Financial Supervisory Authority (FSA), who is an appointee of the previous, Fidesz, government.

Unknown attackers beat up Mr Szasz in June, the night before his agency published a report on an illegal share transaction which led within days to the uncovering of questions about bigger deals at K&H Equities. Now his agency faces an investigation by the finance ministry, which seems to think that the FSA should have uncovered the affair sooner.

KBC, meanwhile, has appointed its Asia-Pacific manager, John Hollows, to clean up the mess at K&H. That means weeding out a last few employees tainted by the scandal and helping police track down the missing money. The stockbroking arm, forced to suspend operations, will be recapitalised and relaunched: its shareholders think it a good business still, despite the embarrassment.

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Economics focus

Into the valley of debt

Sep 25th 2003
From The Economist print edition

Budget finances in emerging economies are in worse shape than in the developed world

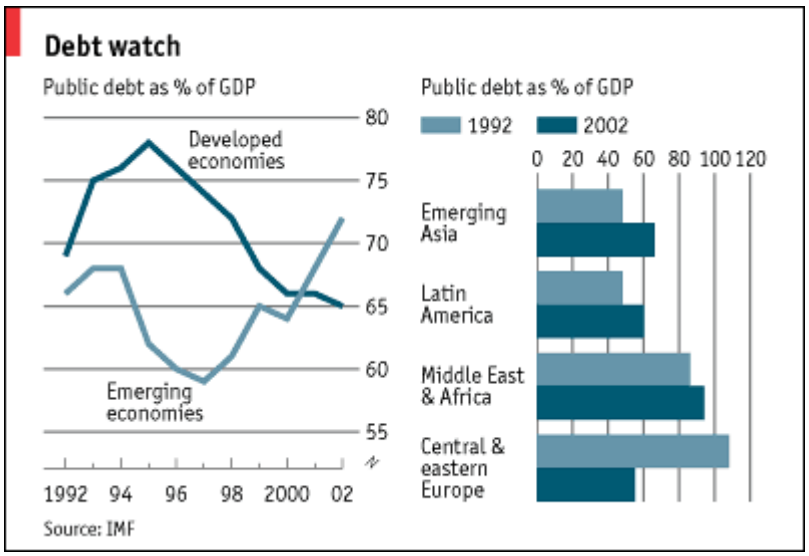
INTERNATIONAL organisations such as the IMF and the OECD are constantly lecturing rich-country governments about their hefty debt burdens. Yet governments in many emerging economies have been even more profligate. In most developed economies, with the notable exception of Japan, public debt has fallen as a percentage of GDP since the mid-1990s. In emerging economies, however, the average debt ratio has risen sharply and now exceeds that in the richer economies.

There are some good reasons for a government to borrow. If the money is used to finance better infrastructure, education or health, it can boost a country's growth rate. On the other hand, excessive public debt can push up interest rates, crowd out private investment or limit the scope for a fiscal stimulus when an economy stumbles. Worst of all, it can lead to default.

A study* in the IMF'S latest *World Economic Outlook* considers whether emerging-market governments have borrowed too much. Public debt in emerging economies amounted to an average of 71% of GDP at the end of 2002, compared with an average of 65% of GDP in developed economies (see chart). Asia and Latin America have seen the sharpest increases in debt ratios over the past decade. In the Middle East and Africa, the average ratio has increased less markedly, but is over 90%. Debt ratios have fallen in central and eastern Europe.

No rich country has defaulted on its public debt since the second world war, but defaults have been far from rare in emerging economies. This has led many economists to argue that, because of their poor credit history, the level of sustainable public debt in emerging economies is lower than in rich economies. Indeed, in over half of all sovereign debt defaults in the past 30 years, public debt was less than 60% of GDP—the ceiling for government debt in the euro area set by the Maastricht treaty.

There are some striking differences in the structure of budget finances in emerging and developed economies. The first is that government revenue amounts to an average of only 27% of GDP in emerging economies (compared with 44% in rich economies) as a result of inefficient tax systems and bigger black economies. This means that debts loom much larger in relation to tax revenues. Revenues are also more variable in emerging economies because of their bigger economic ups and downs. Another difference is that interest payments are almost twice as high as a share of GDP as in rich countries. They are also more volatile, because in poor countries foreign-currency and short-term debt make up a larger share of the total.



The IMF's study uses three different methods to assess whether emerging economies' public debt is sustainable. One popular gauge is the future path of debt to GDP if governments hold their primary budget balances (ie, excluding interest payments) at existing levels. Worryingly, most emerging economies' current budget positions imply ever-rising debt ratios. Another approach focuses on the relationship between debt and changes in the primary budget balance. Emerging-market governments tend, on average, to do much less than those in rich countries to increase their primary surpluses when their debt ratios rise. The authors suggest that because rich-country governments behave as if they have a stronger commitment to keeping their debts under control, they can allow budget deficits to widen in a recession without alarming lenders. But because lenders often doubt the ability of many emerging economies to adjust their budgets to maintain debt sustainability, they quickly get jumpy when deficits widen. This can force governments to slash spending in a downturn, worsening economic weakness.

As a third test, the IMF asks whether a government's debt exceeds the present discounted value of its expected future primary surpluses (based on the average of recent years). If so, the debt is likely to be unsustainable. Using this rule, the study suggests that the sustainable public-debt ratio for a typical emerging economy is only about 25% of GDP, compared with 75% in developed economies. That is well below the current average debt ratio. A weak revenue base, plus an inability to control spending during economic upswings, means that emerging-market economies can generally only sustain lower public-debt ratios than rich economies. They need to run bigger budget surpluses to put their finances on an even keel.

The inevitability of debt and taxes

How can governments slim their debt? The IMF looks at 26 cases during the past three decades in which emerging economies' debt has declined significantly. Of these, 19 involved default, which limited governments' subsequent ability to borrow and thus cramped growth. In the other seven cases, debt ratios were reduced by fiscal restraint. For instance, Chile cut its public debt from 54% of GDP in 1990 to 21% at the end of last year by cutting spending, broadening its tax base and clamping down on tax avoidance, and through privatisation. The rewards have been huge: Chile enjoys lower interest rates than other Latin American countries, and its uninterrupted access to capital markets has helped to support economic activity through downturns.

However, the IMF finds that most of the recent increase in emerging-market government debt has been due not to bigger primary budget deficits, but to large swings in exchange rates and interest rates. Emerging economies need to reduce their reliance on foreign-currency and short-term debt to make interest payments less volatile. Another interesting idea suggested by the IMF economists is that governments could issue bonds on which the interest payments would be linked to a country's growth rate: the faster the rate of growth, the higher would be the interest rate paid in any year. If growth slowed, interest payments would fall, providing a useful cushion in times of economic stress. It is an idea well worth further consideration.

* “Public Debt in Emerging Markets: Is it Too High?”: available on the internet at www.imf.org/external/pubs/ft/weo/2003/02/pdf/chapter3.pdf

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Flood barriers

Saving Venice

Sep 25th 2003 | CAMBRIDGE AND VENICE
From The Economist print edition

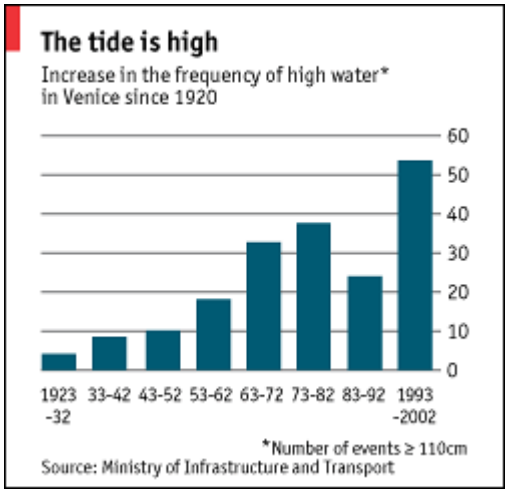
Rex Features

Scientists now largely agree that flood gates are necessary to protect Venice from high water

ANYONE considering a trip to Venice in the next few months would be wise to pack wellington boots. Between now and April the lowest parts of the city will be regularly inundated.

High water is an increasingly frequent problem (see chart). Besides the inconvenience this brings to Venetians and tourists, salty water lapping above Venice's foundations is eating away at the fabric and treasures of this unique and historic city. But for decades there has been an acrimonious debate about what exactly should be done and little routine maintenance work on the structure of the city. So researchers met at Cambridge University this month to survey what is known about the flood risk and the best ways of tackling it.

To grasp the problem, the popular tourist destination of St Mark's Square is an excellent place to start. One of the lowest, and oldest, points in the city, it is home to treasures such as St Mark's Basilica and the Doges' Palace. In the first decade of the 20th century, the square flooded less than ten times a year. By the 1980s it was flooding 40 times a year, and today it floods some 60 times a year. Severe inundations, when more than 90% of the city's surface is under water, are becoming more frequent. Another disastrous flood, such as the one the city suffered in 1966, may only be a matter of time.



Bouncing back

The problem is not simply that Venice is sinking into the mud. It is true that groundwater extraction during the last century may have caused the city to sink by as much as 10cm, but, thankfully, this has since stopped. Roberto Frassetto, an oceanographer at the Marine Sciences Institute in Venice, says that small rebounds might even be

possible if hydrostatic pressure in the aquifer can be re-established. The other reason for the subsidence, which continues unabated, is a natural geological decline of around 0.5 to 1mm per year due to movement of the continental plate and compression of the soil.

The real root of Venice's problems with high water appears to be that sea levels are rising fast. The city's total movement with regard to sea level is about 2.3mm a year (plus or minus about 0.7mm to account for the possible error in scientific calculations), according to Dr Frassetto. Compounding the effects of this problem, changes have been made to the structure of the lagoon which have reduced its natural protection against high water.

One suggested solution is a barrier that will prevent the high tides from entering Venice's lagoon in the first place. The idea is by no means unique. Flood and storm barriers against the sea are now common in various places around the world. London and St Petersburg have such barriers. The Maeslant barrier in the Netherlands is another example.

Nor is the idea of a barrier for Venice new. Dr Frassetto first proposed it in the 1970s. But it took more than a decade for the idea to be accepted, and another two decades before work on a breakwater started this May. Construction will take a decade to complete, and that is only if scientific wranglings and Italy's complicated politics do not cause further delays.

The gates are often referred to as MOSE, or the Moses gates, a name that comes from an experimental prototype called the *modulo sperimentale elettromeccanico*. The nearly €3 billion ($3.4 billion) scheme will comprise about 80 hollow gates embedded in the seabed at the three inlets to Venice's lagoon. When not needed, the gates will rest on the seabed, full of water. But when high tides threaten the city, compressed air will force water out of the gates. This will cause them to rise and act as a barrier to water trying to enter the lagoon.

Will the gates justify their large cost? That question has been fiercely debated by Venetians themselves. Bedevilling that debate is the fact that there are no agreed estimates of the cost of flooding and the savings the gates will bring. And not everyone is convinced the gates are a good idea. For one thing, once they are installed, they will require an estimated €9m each year to operate—money that might be spent on other flood protection measures. For another, since the 1966 flood, many changes have been made that have reduced the damage from high water. Electrical junction boxes have been moved out of the reach of even the highest tides, and the ground floors of many buildings have been abandoned.

Also, much routine maintenance work is now under way to raise, where possible, pavements to act as a barrier to high water (a long-employed strategy to beat the rising water). And the damaged foundations of Venice's 45km (30 miles) of canals, and the buildings that line them, are being repaired and waterproofed.

These are costly and unexciting tasks. Many people, though, believe they are more fundamental to the future of the city than the gates. There are also some, such as Albert Ammerman, an archaeologist from Colgate University in New York, who say that the gates should not be built at all because the designers have underestimated the amount the sea may rise. Debate continues on medium-term forecasts and, when it comes to what will happen to sea levels beyond 2050, nobody can even guess with much confidence.

In high water

However, the most serious objections to the gates have always been environmental. The population of Venice and its accompanying urban sprawl on the mainland pour their sewage directly into the lagoon—relying on twice-daily tides to flush this into the Adriatic. This flushing, says Job Baretta, a consultant on coastal system dynamics, was rapid enough to avoid over-fertilisation of the lagoon until the 1980s, when massive and persistent blooms of algae broke out. Steps were then taken to reduce nutrient run-off into the lagoon from industry, agriculture and sewage, and the blooms stopped. But some worry that if the gates are now closed, even briefly, the balance will be upset again and the lagoon will stagnate.

As a result, the group of engineering and construction companies that are building the gates—Consorzio Venezia Nuova (CVN)—have been told that the gates must reduce water exchange between the lagoon and the Adriatic by only 5%. Many, including Dr Baretta, believe that the gates are unlikely to cause stagnation anyway. They will be closed only for short periods of time and only during the winter when the water temperature and light are too low for algal blooms. But Dr Baretta warns that the jetties proposed

along with the gates will be a problem—reducing flushing of the lagoon, and thus its water quality.

Nevertheless, Donald Harleman, a hydrologist at the Massachusetts Institute of Technology, argues that it is possible to use selective operation of the gates, when there is no flood risk, to actually increase flushing. There are three gates, and circulation could be aided by keeping some open at some times, and closed at others. He adds, rather pointedly, that there is rarely a mention of the real solution to this problem: collect and treat Venice's sewage. Treatment plants for the most densely populated mainland areas of the lagoon have recently been approved and should be built by 2006.

If there is one thing that researchers do agree on, it is that the gates are not the sole solution. Many think something must be done to halt and reverse changes to the structure of the lagoon that have reduced the flood protection it provides for the city. Pierpaolo Campostrini, director of CORILA—a consortium for co-ordinating research concerning the Venice lagoon system—says that the lagoon is being transformed from a marsh into a completely marine environment. Sediment-carrying rivers have been diverted, sea level has risen (increasing the volume of water in the lagoon), a deep-water channel has been dredged for shipping, and turbid waters are killing the eel grass that stabilises mud flats.

Giovanni Cecconi, the head of engineering at CVN, explains that way back in 1810, protective salt marshes occupied more than 150 square km of the lagoon, but by 1998 these had declined to only 33.5 square km. What should be a shallow, marshy environment, complete with a complex set of channels, islands and sand bars is becoming a flat, scoured bay subject to the full force of the Adriatic. And the deeper the water gets, the greater the wave energy that can build up. This results in a further deepening of the lagoon. Dr Cecconi says that between 1950 and 1960, the rate of erosion in the lagoon increased by 20 times.

Restoration work, such as reconstructing salt marshes near the island of Burano and sand dunes at Cavallino, and planting eel grass all over the place, is part of the solution. But sediment is being lost at a rate of 700,000 cubic metres a year. This is so serious that the authorities have twice considered rediverting a river into the lagoon.

Another solution is to use sediment dredged from navigation channels in one part of the lagoon to build beaches and new islands or to reinforce old ones in another part. But in some areas, sediments are so polluted with toxic chemicals, such as mercury, that the mud must be stored in a dump. Instead, Alberto Scotti, president of Technital, an engineering consultancy, that works for the Venice Water Authority, says that the CVN is evaluating a plan to import mud from where it is accumulating behind a hydroelectric dam.

Despite lingering doubts over the gates, construction has begun with a breakwater at the Malamocco inlet into the lagoon. The gates will certainly buy the city time, while more controversial long-term solutions—such as closing off the lagoon permanently—can be considered.

Gate expectations

The root of much of the acrimony over the gates has been suspicion about the body responsible for building them, CVN. This state-backed consortium includes most of Italy's biggest building and engineering firms, and they alone have been charged with defining the nature of Venice's flooding problems and designing and implementing a solution. Many Venetians are quite naturally suspicious that an expensive structure has been proposed by the companies that are being paid to build it.

Looking ahead, Anna Somers Cocks, chairman of the Venice in Peril Fund, warns that the way work on the project is being implemented is guaranteed to lead to further problems. The Venice Water Authority, she warns, does not have independence and influence over CVN, and so cannot monitor its work in any credible way.

She also hopes that the gates will go some way toward addressing Venice's other basic problem—its loss of residents. Venetians have been leaving the city in droves—its population of 60,000 is now half of what it was only a few decades ago. If the gates stop the continual flooding of the city, it will make a big psychological change to the city, she suggests. Venice might then become a city where more people will want to live, invest and do business, rather than just visit. Although the future holds much promise, it is too early to say whether Venetians will ever be high and dry again.

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Malaria and the Gates Foundation

Clearing the air

Sep 25th 2003 | MANHIÇA
From The Economist print edition

Malaria research gets a shot in the arm

MOZAMBIQUE is a country that tries to take health seriously. Its prime minister, Pascoal Mocumbi, is a doctor. Its president, Joaquim Chissano, might have been one too, but Frelimo, the former liberation movement that now governs the country, could not afford to keep both him and Dr Mocumbi at medical school.

Although the liberation war is long over, money is still tight. So a little help from one's friends is always welcome. And few friends are more welcome than the Bill and Melinda Gates Foundation, a charity set up by the world's wealthiest man and his wife.

The foundation has $25 billion in the bank and seems to be on a mission to cure the world. It thus suited both sides that Mr and Mrs Gates announced the foundation's latest largesse, $168m, at the Manhiça Health Research Centre in southern Mozambique. By no means all of the money will be spent in this country. But it is all directed towards eliminating one of Mozambique's worst plagues—malaria.

Malaria kills about 1m people a year worldwide, almost all of them African children. Furthermore, it also imposes a huge economic burden. The World Health Organisation estimates that malaria costs African countries $12 billion a year in lost production. And the poorest households spend much of their disposable income combating the disease.

Depending on whether you are an optimist or a pessimist, the grant is a significant boost or a drop in the ocean. Compared with existing anti-malarial spending (about $200m a year) it is the former. Compared with the estimated need (about ten times that) it is the latter.

The money will be spent over the next four years. It will be spent in several ways: devising new drugs, employing existing drugs in novel ways and, most crucially of all, in finding a vaccine. The Manhiça research centre is already working on vaccine and drug development.

Creating a vaccine against malaria has been difficult. Existing vaccines work against viruses and bacteria, but the parasite that causes malaria is a more complex type of organism. However, since natural immunity to malaria exists, researchers are reasonably optimistic that a vaccine, which stimulates this immunity artificially, should be feasible.

In pursuit of this goal, the clinic is conducting a large trial of a vaccine developed by GlaxoSmithKline. It works by introducing a protein whose surface resembles that of the malaria parasite, thus inducing an immune reaction. The 2,000 children in the villages around Manhiça who are involved in the trial may be among the first to find out if it works.

The Manhiça clinic is also looking into another kind of vaccine. A few years ago, Pedro Alonso, the centre's director, was working in Tanzania. He discovered that infants given doses of an anti-malarial drug called Fansidar along with their regular childhood vaccinations often acquired immunity to malaria. Dr Alonso and his colleague Ricardo Thompson are now following this discovery up in the villages around Manhiça.

Their theory is that single doses of Fansidar reduce a child's load of the parasite to the point where the symptoms disappear. The child's immune system can then learn to recognise the parasites and respond to future infections without suffering life-threatening symptoms. In effect, the parasites are being subverted to act as a natural vaccine. It is hoped that three doses over the course of a year will be enough to confer long-term immunity. It also seems to work in quite a lot of children. Dr Alonso's

previous work in Tanzania showed that immunity was conferred in 59% of them.

Conducting clinical trials in rural Africa is no easy task. A lack of maps means the researchers have to locate each house involved using the satellite-based Global Positioning System. But Dr Alonso and his colleagues hope that the results of both trials will be out next year. If either result is positive, it will be a big step towards controlling malaria.

Our correspondent travelled with Bill and Melinda Gates to Mozambique at *The Economist*'s expense.

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Head size and mental ability

On getting a head

Sep 25th 2003
From The Economist print edition

Why people with large heads suffer less cognitive decline in old age

EXACTLY what the size of a person's brain means for his various abilities has been hotly debated for years. A few years ago, a study found that babies with high birth weights—who invariably have bigger heads—had better reading skills, superior reasoning and more robust memories, among other things, well into their twenties.

Christopher Martyn and his colleagues at the Environmental Epidemiology Unit in Southampton also knew that older people with big heads fared better in their golden years than those with small ones, but were hesitant to accept that most of the critical brain growth took place in utero. What might explain this connection between big-headedness and preservation of faculties in later life?

They decided to investigate by recruiting 215 male and female volunteers born between 1922 and 1930. Midwives' notes had recorded their head size at birth. They measured current head size, height and gave volunteers standard IQ and memory tests. They also screened them for depression. Three and a half years later these tests were repeated.

They found that a large adult head size was beneficial in preventing cognitive decline, in particular memory. At the other end of the spectrum, though, the news was grim. Those with the smallest heads had up to a fivefold greater risk of cognitive decline over this time than those with the largest. But, when the researchers analysed the data to see if head size at birth was protective, they found it was not, as they explain in the October issue of *Brain*.

Why the discrepancy? There is no denying the importance of development in the womb. The last third of pregnancy is one long growth spurt for the fetal brain. But brain growth keeps up quite a pace after the child is born as well: in the first year alone, a baby's brain doubles in weight and by the time a child is six, brain weight has tripled. At that tender age, a child's brain has already attained about 93% of its final size.

Dr Martyn's theory is thus that brain development during infancy and early childhood is more important than fetal growth in keeping the lights bright—and that those gains last well into old age.

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Soviet cultural history

Dancing in the dark

Sep 25th 2003
From The Economist print edition

Corbis

Communism's cultural competition with capitalism was a long losing battle

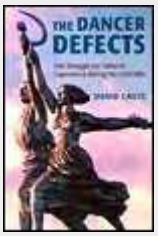
WHEN the Soviet Union ran out of money in the 1980s, it lost the cold war. But it had run out of ideas long before that. The struggle between the propagandists of the Soviet empire and their western counterparts which preceded that defeat is the subject of David Caute's formidable new work of cultural history.

Looking back, it is hard to imagine that the impoverished, senile Soviet Union of the final decade of the conflict had ever had much to boast about. But in the exciting years following the Russian revolution, during the economic misery of the 1930s, in the struggle against Hitler and then in the ruins of post-war Europe, things were very different. In the minds of many, capitalism was to blame for a global slump followed by war, while communism had brought literacy and industrialisation to Russia, and victory over Nazism in Europe. Luminaries from Bertolt Brecht to Charlie Chaplin voted with their feet, fleeing America to avoid McCarthy's witch-hunts of the 1950s. The money and effort the Soviet planners could give to high culture sometimes dwarfed the contribution that western societies were willing to make.

Against that background, America and western capitalism were a hard sell to many people, for whom the Soviet Union and socialism, by contrast, seemed a bit more attractive. Mr Caute's book, the first of two, reports the battlefields of art, music, film and drama. He unpicks, scene by scene, the absurd, long-forgotten propagandist works of both sides.

Paradoxes abounded. The biggest was that the Soviet Union was both boastful and secretive, yearning to seem creative while maintaining a stultifying rigidity. Even at the height of the anti-communist hysteria, America was an infinitely more open, more dynamic, more flexible society than the totalitarian monolith behind the iron curtain. America's propaganda war needed only touches on the tiller, and dabs of CIA money here and there: every author that could find a publisher, every play with a producer, every gallery owner, every impresario, every editor was a protagonist in the battle of ideas, just by virtue of their own freedom of action.

The Dancer Defects: The Struggle for Cultural Supremacy During the Cold War
By David Caute



Oxford University Press; 788 pages; $39.95 and £30

Buy it at
Amazon.com
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In the Soviet Union, by contrast, culture was a matter for the central committee and the Politburo. What kind of modern art should be allowed? Was jazz decadent? Which foreign plays should be staged? Even to pose these questions was all but unimaginable in the West; yet they were matters of state in the East. When Nikita Khrushchev, in a moment of notorious philistinism, denounced abstract modern painting during a visit to the Manezh gallery in Moscow in 1962, it changed the future course of Soviet art, breaking countless careers in the process. What Richard Nixon, LBJ or Harold Macmillan may—or may not—have thought about modern art was hardly a scratch on the canvas.

As with all command economies, planners' mistakes proved easily made but hard to rectify. The Soviet culturecrats badly misjudged youthful musical taste. As a result, rock music became a powerful solvent of the state's credibility and power to inspire loyalty. In the end, the Soviets' instinctive desire to control everything, everywhere, trumped any real attempt to be as popular as their ideology told them they should be.

That reflects a second big paradox. The supposed revolutionaries of the Soviet system were in practice ultra-conservatives. They liked realistic art (proper pictures of proper things), classical music traditionally interpreted, and good solid stories with a nice uplifting moral. The Victorians would have felt quite at home. The Americans, by contrast, for all their homespun and godfearing instincts, wanted to demonstrate what freedom of expression meant. They ended up funding avant-garde art, and music and literature of a kind that many of their own voters would have found mystifying or even repellent.

For all its intriguing insights, its descriptions, research and enviable perspective, Mr Caute's book is patchy. He details rather too comprehensively for the lay person the intricacies of the tussles in France and Germany, but neglects almost completely other cold-war arenas—Italy, Scandinavia, Japan and Yugoslavia, not to mention Africa, Asia and Latin America. He has left out the battle of the airwaves, where both sides expended huge amounts of time, effort and money on radio stations that ranged from the overtly propagandist to the clandestinely tweaked.

Yet for the big picture as well as plenty of little ones, the result is still masterly. The author's final polemic, against the bogus academic discipline of “cold war studies”, a jargon-plagued nonsense in which the Soviet Union appears as a near-fictitious bystander in an internal American power struggle between wicked right-wingers and valiant lefties, is worth the price of the book alone.

The Dancer Defects: The Struggle for Cultural Supremacy During the Cold War.
By David Caute.
Oxford University Press; 788 pages; $39.95 and £30

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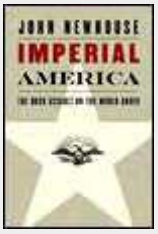
American foreign policy

About turn

Sep 25th 2003
From The Economist print edition

INSIDE this shrilly packaged attack on the foreign policy of the Bush administration there is a thoughtful critique struggling to get out. In partisan mode, John Newhouse traces a large share of America's present travails to Washington itself. The trouble in his eyes lies less with relentless foes, under-strength allies or the sheer bloodiness of the world than with George Bush and the advisors he picked to serve under him.

Imperial America: The Bush Assault on the World Order
By John Newhouse



Knopf; 194 pages; $23

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Mr Bush, he tells us, represents a hard-right swing away from half a century of foreign policy that never strayed far from the political centre. Truculent and dogmatic, his administration threatens to squander a tradition of international success built up by Democrats and Republicans alike from Franklin Roosevelt to Ronald Reagan, George Bush senior and Bill Clinton. It has bungled the fight against terror, lost the plot in Iraq, muffed chances in Iran and is now shirking the worst dangers of all, in Pakistan. The administration's doctrine of pre-emption will not answer the threat of nuclear terror, but it may bankrupt the country.

That is a sweeping indictment. Like a silo-busting missile, Mr Newhouse has gone for overkill. But even critics of the administration must question his aim. He underplays old fault-lines in American foreign policy and overdoes the coherence of Mr Bush's radicalism. Somewhat contradictorily, he faults the administration for confusion and infighting, as if those were new. Remember Henry Kissinger and William Rogers or Zbigniew Brzezinski and Cyrus Vance?

Reuters

He says it's overkill

Mr Newhouse accepts that on many of the trickier issues—reform chances and nuclear intentions in Iran or how to handle North Korea, for example—you can argue it two ways, and he cedes points to the president's hard men. No innocent peacenik, he generally agrees with them that the world is a dangerous and in parts hostile place. Yet, case by case, he cannot help concluding that Mr Bush must be wrong.

This is a shame. When he parks his anti-Republican rage, Mr Newhouse is worth listening to. He has written on foreign affairs in the *New Yorker* and other publications for nigh on 30 years. His experience in government on arms control and European issues has taught him much about how Washington works.

Nuclear weapons, Mr Newhouse thinks, represent the greatest danger to world security. Using his expert knowledge, he considers the threat from many angles: proliferation, terror, the existing huge stocks in Russia and America. In facing these questions, he thinks the United States should rely more on negotiation, allies and multilateral bodies than, in his view, Mr Bush is ready to accept.

It is a long way from April to September. The hawks in the administration look less sure of themselves than they did last spring when Mr Newhouse was finishing this essay. There are probably more people in and around the administration who agree with him than he thinks. This book would be of better use to them had he not wrapped his arguments in an anti-Bush polemic.

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By John Newhouse.
Knopf; 194 pages; $23

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Literary memoirs

Things that might have been

Sep 25th 2003
From The Economist print edition

MEMOIRS of childhood are three a penny, memoirs of guilt-edged Catholic childhoods two a penny; but Hilary Mantel's book, which is both of these, is extraordinary. She catches the very essence of the growing child, the small sharp-eyed observer in the corner of the room who is herself ignored and not explained to, and carries that persona through—as we all do—to her years of ostensible maturity.

Published in Britain earlier this year, this book became famous for its description of Ms Mantel's long struggle with undiagnosed endometriosis. But that section is comparatively short and straightforward. It is the earlier illnesses that creep up with acute and disturbing tread, like the migraine that "plants on my forehead a clammy ogre's kiss". Almost from the beginning, Ms Mantel knew there was "something inside me that was beyond remedy", a body that was not her own. Her book, as she describes it, is an attempt to "write myself into being: to locate myself, if not within a body, then in the narrow space between one letter and the next." She is haunted both by the children she could never have and the books she has never managed to write, insistent ghosts.

Such preoccupations suggest a gloomy book, as do its settings: the shingle of Norfolk, the wet, dark moors of Derbyshire, or 1950s houses with their dark green and crimson paint. The experience is completely the reverse. Ms Mantel is a jaunty, self-deprecating companion, and her descriptions of the tiniest things are a constant joy. Upright pianos have a "deep, disdainful, private aroma". A kitchen carries "a scent of inner peapod". An old man's failing heart knocks about "like a wasp in an inverted glass". Best of all comes the devil of her childhood, sprucing himself to walk in the world: "I imagine how he sleeks his rough fur with babies' fat, polishes his teeth with ground bones, and swills his mouth with blood; then taking from its peg his tall shiny hat, he sets it upon his head to hide his horns."

Giving Up the Ghost: A Memoir.
By Hilary Mantel.
Henry Holt; 240 pages; $23.
Fourth Estate; £16.99

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Film autobiography

Marathon man

Sep 25th 2003
From The Economist print edition

NEAR the end of his autobiography, John Boorman goes to the 1987 Academy Awards on the night that his most personal film, “Hope and Glory”, was nominated for five Oscars, but lost out to Bernardo Bertolucci's “The Last Emperor”.

The chapter he devotes to it is the book in miniature, with candid observations of the rich and famous: Glenn Close more pregnant than in “Fatal Attraction”, Tatum O'Neal confessing that she is cursed with a memory like flypaper and Mr Bertolucci that he has given up on therapy now that he has a hit. In the midst of it, our suburban boy keeps getting locked out of the auditorium each time he dashes to the bar for a drink. When Cher gets up to collect her Oscar, he is standing on her beaded dress, part of which tears away, earning him “a look so lethal that it almost stopped my heart”. In the end, though, Mr Boorman won the moral victory. “Hope and Glory”, a quintessentially English film made without a farthing of British money, went on to garner worldwide acclaim, including a record 13 BAFTA nominations. And then came the two blockbusters, “Deliverance” and “Excalibur”, and a number of films whose long shelf life is a measure of their enduring popularity.

Adventures of a Suburban Boy
By John Boorman

Faber and Faber; 320 pages; $27 and £15.99

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But “Adventures of a Suburban Boy” is not just gossip and illuminating snippets about film, although it certainly offers plenty of both. Mr Boorman's agonising account of Toshiro Mifune's mulish misconduct during the making of “Hell in the Pacific” should be recommended reading for any director who ever thought he was stuck with a difficult star. But the heart of the book is the story of how this full-blown late Romantic grew up in semi-detached suburbia by the River Thames during the second world war, and set out from there in search of a rainbow that turned out to be made of celluloid.

It is the childhood sections that give the truest insight into Mr Boorman's films: the presence of water, all the desperate lovers' triangles modelled on his parents' marriage, which helped the director breathe life into Britain's best-loved triangle in “Excalibur”, his personal reworking of Sir Thomas Mallory's story of King Arthur with Wagnerian accompaniment.

After the satiric look at Oscar night, a twilight-of-the-gods mood settles over the book as Mr Boorman describes the deaths of Lee Marvin, whose support enabled him to make his extraordinary film noir, “Point Blank”; of his long-time collaborator, Bill Stair, and of David Lean. It is a bit of a relief to learn that Mr Boorman is only 70 years old and that he began the book after winning his second best director award at the Cannes film festival. Akira Kurosawa, one of hundreds of sharply observed portraits in this book, made two of his best films in his 80s, so there is no reason why this modest English maverick shouldn't keep astonishing audiences with his outsized gifts—and more often than not pulling it off.

Adventures of a Suburban Boy.
By John Boorman.
Faber and Faber; 320 pages; $27 and £15.99

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New fiction

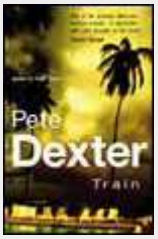
Oh lucky man

Sep 25th 2003
From The Economist print edition

GOLF, racism, violence and various other forms of human unpleasantness are the themes of Pete Dexter's grim but utterly gripping new novel. Set in Los Angeles in the early 1950s, it introduces three characters whose stories begin separately but soon converge and become messily entangled.

Train is a caddy at a fancy Los Angeles country club. He is quiet, smart and hard-working. Not that anybody has bothered to notice. Since he is black, a good day is when Train is ignored or patronised, rather than ripped off or beaten up. So caddying for a visitor called Miller Packard comes as a nice change of pace. Packard immediately takes a shine to Train, and Train is intrigued by Packard's air of “mile-away” detachment. Packard is independently wealthy but works as a cop, which allows him to indulge his love of slumming, thrill-seeking and confrontation, hence the pistol in his golf bag.

Train
By Pete Dexter



Doubleday; 280 pages; $24.95. To be published in Britain by Heinemann in January 2004

Buy it at
Amazon.co.uk

Later, when he is called out to a crime scene, Packard meets Norah, the beautiful young wife of an elderly millionaire. Norah has been raped and horribly mutilated, and her husband murdered. Though neither Packard nor Norah knows it at the time, the culprits are two of Train's co-workers. Packard takes both Norah and Train under his wing and Mr Dexter's unlikely triangle falls into place. Without giving too much away, Norah becomes pregnant and Train, under Packard's guidance, goes on to achieve great success on the high-stakes underground golfing circuit; but trouble is always lurking just around the corner.

“Train” is, line by line, a superbly written book. It is also cunningly structured for maximum impact. As readers of Mr Dexter's previous books (“Paris Trout” and “The Paperboy” among them) will know, he paints a gloomy picture of human relations. But the novel is also illuminated by vivid flashes of humour and humanity. Above all there is Train himself, who remains sensitive to the needs of others, alive to the richness of the world around him and capable, despite everything he has to put up with, of feeling “luckier than Moses in an inner-tube”.

Train.
By Pete Dexter.
Doubleday; 280 pages; $24.95. To be published in Britain by Heinemann in January 2004

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History in the theatre

All our yesterdays

Sep 25th 2003
From The Economist print edition

Modern history treads the boards

My splintered heart

SHAKESPEARE, of course, was obsessed with history, whether via Holinshed's “Chronicles” or the Roman histories that gave rise to “Julius Caesar”, “Antony and Cleopatra”, and “Coriolanus”. But modern drama by and large tends towards the a historical. So it comes as a welcome surprise to find two London plays within one week putting vibrant flesh on some relatively little-known swathes of the not-too-distant past.

In the Almeida Theatre's “I.D.”, Sir Antony Sher, a South African émigré who went on to become a British actor-knight, makes his playwriting debut with a vivid if somewhat gerrymandered piece centred around the murder, on October 6th 1966, of the architect of apartheid, the-then prime minister, Hendrik Verwoerd.

“Democracy”, a new play from Michael Frayn at the National's Cottesloe Theatre, begins almost exactly three years later and concerns one man's ruination of another, not physically but spiritually. Why was the German chancellor, Willy Brandt, done in by Günter Guillaume, Brandt's East German-born aide-de-camp who happened also to be a Stasi spy? The answer, in Mr Frayn's hypothesis, lies not just in the divided country that is Germany but in the two men's divided selves. Or, as Shakespeare put it in “Richard II”: “I hate the murtherer/love him murthered”.

Guillaume's criminal actions, in other words, owe more to his own crippling self-loathing that resulted in Brandt, the victim, at the same time seeming beloved. In his last play, the highly regarded—perhaps too reverentially regarded—“Copenhagen”, Mr Frayn shone a historian's torch on a defining weekend during the second world war when two atomic physicists, Niels Bohr and Werner Heisenberg, discussed nothing less than man's ability to annihilate itself.

“Democracy” doesn't march to quite the same apocalyptic drum, but it's considerably more theatrical, even juicy, especially as it is staged within an inch of its life by the author's long-time director, Michael Blakemore, here in top form. And as the colleagues-turned-adversaries, Conleth Hill and Roger Allam make a sublime pair as the spy and the espied, their anguished selves cracking in two even as their fractured country is made whole.

“I.D.”, which is told in flashbacks, ends with a healing of sorts—the dismantling of the apartheid system that Verwoerd shepherded so hatefully into being. But the focus of Sir Antony Sher as author is less on Verwoerd (who is played with a chilling reasonableness by Marius Weyers) than on the role of the

assassin, Demetrios Tsafendas, here given to Sir Antony, the actor. Part-Mozambican, part Greco-Portuguese, Tsafendas, like the two men in “Democracy”, is clearly a many-splintered self. The play literalises his schizophrenia by dramatising the so-called “inner tapeworm” to which Tsafendas, who died in 1999, aged 81, long ascribed his actions. And as Tsafendas vomits forth the character of the Lintwurm (Alex Ferns), Sir Antony the playwright gives us both a guide through a country's turbulent past—think of the Lintwurm as an equivalent to the Emcee in “Cabaret”—and the embodiment of one man's ceaseless internal struggle. The result, as with “Democracy”, is to humanise what could have been a dust-dry treatise; instead, both these authors know that history works best on stage when it is accompanied by a heart.

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About sponsorship

New film

Tokyo rose

Sep 25th 2003 | LOS ANGELES
From The Economist print edition

Romance to die for

“LOST in Translation”, Sofia Coppola's flawless second feature, is as difficult to categorise as her first, “The Virgin Suicides”, about five small-town sisters who commit suicide one by one before life can sully their perfection.

Her new film recalls certain films of the 1960s and 1970s, both European and American, in which two people come together out of a shared sense of isolation that turns into love, only to part at the end for reasons that are never quite spelled out. In “Lost in Translation” perfect things that can't last are laced with moments of hilarity, thanks to Bill Murray, starring as Bob Harris, a Hollywood celebrity who has come to Tokyo to shoot a whisky commercial for $2m, when really he should be doing a good play in an off-Broadway theatre for a nominal fee.

The early scenes of the character's bemused humiliation at the hands of a Japanese commercial director, who thinks he's helming “The Seven Samurai”, portray “Bob-san” as a victim of globalisation in reverse, exploited by a Japanese company who can afford to pay a shopworn star a fortune to help them separate the locals from their yen. By way of thanks he is sent a middle-aged hooker who orders him to “rip” (sounds like “lick”) her stockings, then falls on the floor in a shrieking imitation of Lillian Gish playing the mother of all rape scenes, nearly garrotting her “attacker” with her scissoring legs—an ironic comment on how the sexual fantasies of imperialists are imagined, and exploited, by the objects of their dastardly desires.

Jet-lagged and alone (his wife is a voice on the phone), Bob falls under the spell of a young married woman, Charlotte (Scarlett Johansson), who is staying at the hotel while her photographer-husband John (Giovanni Ribisi) is out all day shooting a local rock group. After John returns in the evening bubbling with self-aggrandising chatter, he quickly falls prey to a ferocious case of sleep apnoea that exacerbates Charlotte's own case of jet lag and eventually leads to a series of accidental, then not so accidental, encounters with Bob in the bar.

The two insomniacs quickly find an intimacy with each other that has gone missing in Bob's marriage and can't ever have existed between Charlotte and John, who's more at home with his pal Kelly (Anna Faris), a motor-mouthed bimbo in town for a press junket to sell her latest movie in the all-important Japanese market. Charlotte and Bob grow so fond of each other that she stays behind when John travels to Fukuyama to photograph his clients, while Bob extends his stay by agreeing to endure additional humiliation at the hands of a Japanese talk-show host—think Pee Wee Herman on crystal meth—just to spend one more weekend with her.

Ms Coppola has an affinity for hotels. Her first screenplay was “Life Without Zoe”, which she co-wrote with her father, Francis Ford Coppola, as his contribution to “New York Stories”, about a character like Kay Thompson's Eloise. Later she and Coppola senior actually wrote a 30-minute television film about Eloise, the little girl who lives at the Plaza in New York. As a clothing entrepreneur in her twenties, Ms Coppola spent a lot of time in Tokyo, and “Lost in Translation”, filmed in and around the Tokyo Park Hyatt hotel, is a guided tour of her favourite haunts, with cameos by local friends playing crazy characters. It is the ideal setting for this bittersweet fairytale, the mood for which is set by Tokyo's night-time neon—as if a piece of “One From the Heart”, her father's greatest folly, had landed on a distant island and morphed into something lovely and strange.

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About sponsorship

Gareth Williams

Sep 25th 2003
From The Economist print edition

PA

Gareth Williams, a radical Welsh lord, died on September 20th, aged 62

Get article background

ACCORDING to his friends, Gareth Williams was reluctant to be made leader of the House of Lords. Understandably so. The Lords is in as big a mess as any it has encountered since it emerged aeons ago from the mists of English history.

Before being appointed to the Lords in 1992 Gareth Williams's career as a lawyer had been relatively simple. Tough, certainly; it was, he said, his “rat-like cunning and barking egomania” that had enabled him to climb to the top of his profession, with clients that included Diana, Princess of Wales, and Michael Jackson. But at least life was straightforward. You won or you lost. In the Lords he found himself in a world of make-believe. He was no longer Mr Williams. He was Lord Williams of Mostyn (the Welsh town where he was born). For ceremonies attended by the queen he was expected to wear an ermine gown (he would borrow one for the occasion). Worse, the Lords was composed of unelected members. Most sat and voted in the Lords only because this privilege had been passed on through the family. There was a sprinkling of senior clergy. And there were lords appointed for life by the prime minister, as the new Lord Williams had been.

Reform was in the air, as indeed it had been for as long as anyone could remember. So was anti-reform. If it works, don't fix it, said the Lords' defenders. They had a point. In a muddled English way the Lords worked, revising legislation proposed by the Commons. Many hereditary peers rarely turned up. Those that did, and the life peers, often had sensible things to say. But it was difficult to argue that the Lords was other than an anachronism.

When the present Labour government was elected in 1997, the Lords in its existing form was doomed. For a start, in 1999 most of the hereditary peers were told to go; only 92 survived the massacre, and they were warned that they were under sentence of death. But what was to replace the Lords as a revising body? Everyone interested in politics had an unbudgeable opinion. That was the unsolved problem tossed to Lord Williams when he became leader of the Lords in 2001.

Born in a taxi

Solving the insoluble seems to have been one of his gifts. His family spoke Welsh, a noble language but not much use outside Wales. Young Gareth taught himself English, using language records. He was determined to be a lawyer, usually a costly career to get a start in. The family was not poor, but it was careful. One of the occasions on which it went to the expense of hiring a taxi was to take Mrs Williams, pregnant with Gareth, to hospital. Gareth was born during the journey. He won a scholarship to Cambridge, gained a first in law and was admitted to the charmed circle of barristers (who in Britain work in the higher courts). He honed his skills as a defence lawyer but as his reputation spread for his skill in cross-examination and handling juries, he began to be offered libel work, where the big money is made.

The king of the libel lawyers was the late George Carman, who, it was said, took his victims into a “bloodless abattoir” and delivered them into the “boneyard of damaged reputations”. Gareth Williams's “rat-like cunning” may have persuaded him that he could not copy Carman. He won his cases by quiet persuasion. His victims acknowledged that their tormentor was always a gentleman.

In politics he called himself a “radical”, a vague word that may mean only that you are not a conservative. As a lawyer he had favoured using simple language rather than jargon. He was in favour of “organic, incremental change” in government. There should be more women in Parliament. All that sounded promising. The ruling Labour Party has many radicals and while it was still in opposition it was happy to recruit the brilliant lawyer and turn him into Lord Williams. When Labour won in 1997, he rose rapidly to become attorney-general, the government's chief legal adviser. Even his dog Bippy (in the picture) was considered unusually intelligent: it was made Westminster's “dog of the year” in 2002.

The Labour hierarchy believed that he was the one man that could solve the problem of what to do with the Lords. Lord Williams, it was constantly said, really understood that politics was the art of the possible, and, among his gifts, had the charm to overcome opposition. Never mind that Tony Blair had given him a seemingly impossible brief: the prime minister wanted an appointed Lords, not an elected one, perhaps obstinately opposed to the government's plans.

Lord Williams had no problem sacking the hereditaries but he wanted them replaced by elected members. However, he accepted his master's brief. In a move to take some of the heat out of the debate over a bill to bar the hereditaries, he had T-shirts printed. On one side was “Kill the Bill” and on the other “La Reine le Veult”, the traditional phrase that a bill has become law.

Everyone said it was a typically witty gesture by Lord Williams. But it appeased no one. When he died suddenly last weekend, his colleagues said that he was probably irreplaceable. A conventional and kindly comment, and in this case it may be accurate.

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Overview

Sep 25th 2003
From The Economist print edition

The **dollar** tumbled after a Group of Seven communiqué called for more "flexibility in exchange rates." America's currency fell to a three-year low against the yen and an eight-week low against the euro. It also fell to two-month lows against sterling and the Australian and Canadian dollars.

Oil prices rose, after OPEC agreed to cut output. The price of a barrel of West Texas Intermediate crude for November delivery rose by 4% to more than $28.

Although mortgage-interest rates fell slightly, demand for **mortgages in America** slipped. Applications declined for both purchase loans and refinancings.

The dollar's weakness and worries over rising oil prices caused trouble for **stockmarkets**. **Japanese** shares felt some of the sharpest pain: they experienced their largest one-day fall in more than two years in reaction to the prospect of a stronger yen. Over the week, the Nikkei 225 fell by 4.4% while the Topix index dropped by 2.7%.

European and American shares also fell. For the week, **Germany's** DAX index was down by 7.1% and **France's** CAC-40 fell by 3.8% as currency worries undermined hopes of an improving climate for euro-area manufacturers. **Britain's** FTSE 100 and **America's** Dow Jones Industrial Average both declined by 1.3%.

The **euro area's** current-account surplus fell to €1.2 billion ($1.4 billion) in July from €2.8 billion in June, while the trade balance rose to €12.2 billion ($13.9 billion) in July from €6.7 billion in June.

Consumer-price inflation in **Germany** ran at 1.1% in the year to September, unchanged from the year to August. Cheaper fuel and holidays balanced a hot-weather-induced spike in food prices.

Italy's industrial production rose by a better than expected 1.5% in July. For the year to July, industrial production grew by 0.4%. Unemployment in July held steady at 8.7%, the lowest rate since June 1992, and down from 9.0% a year ago.

Canada's CPI rose by 0.2% between July and August and by 2% in the year to August. Inflation has fallen in Canada over the past year thanks to economic weakness and a stronger Canadian dollar.

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Output, demand and jobs

Sep 25th 2003
From The Economist print edition

% change on year ago

	GDP			The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate		
	latest		qtr*	2003	2004	latest		latest		latest		year ago
Australia	+ 2.0	Q2	+ 0.5	+ 2.8	+ 3.5	nil	Q1	+ 3.6	Q2	5.8	Aug	6.2
Austria	+ 1.0	Q1	+ 0.7	+ 0.5	+ 1.4	– 1.9	Dec	– 0.5	Jun	4.5	Jul	4.3
Belgium	+ 0.8	Q2	– 0.4	+ 0.7	+ 1.6	– 5.9	Jun	– 1.7	Jun	13.3	Aug†	12.0
Britain	+ 1.8	Q2	+ 1.3	+ 1.8	+ 2.4	– 0.5	Jul	+ 3.8	Aug	5.1	Jul††	5.2
Canada	+ 1.6	Q2	– 0.3	+ 2.2	+ 3.0	+ 0.5	Jun	+ 2.3	Jun	8.0	Aug	7.5
Denmark	– 0.8	Q2	– 1.8	+ 1.1	+ 2.1	+ 1.6	Jul	+ 2.2	Jun	6.0	Jul	5.1
France	nil	Q2	– 1.3	+ 0.7	+ 1.9	– 1.1	Jul	– 2.2	May	9.6	Jul	9.1
Germany	– 0.2	Q2	– 0.2	nil	+ 1.3	+ 1.4	Jul	– 2.4	Jul‡	10.6	Aug§	9.8
Italy	+ 0.3	Q2	– 0.3	+ 0.5	+ 1.6	+ 0.4	Jul	– 2.1	Jun	8.7	Jul	9.0
Japan	+ 3.0	Q2	+ 3.9	+ 1.5	+ 1.3	– 0.3	Jul	– 2.6	Jul	5.3	Jul	5.4
Netherlands	– 0.9	Q2	– 2.1	– 0.2	+ 1.4	– 3.2	Jun	– 1.1	Apr	5.3	Aug**	4.2
Spain	+ 2.3	Q2	+ 2.7	+ 1.9	+ 2.6	+ 1.7	Jul	+ 3.6	Jul	11.4	Jul	11.3
Sweden	+ 1.3	Q2	+ 1.2	+ 1.5	+ 2.2	+ 2.5	Jul	+ 5.0	Jul	5.4	Aug†	4.1
Switzerland	– 1.0	Q2	– 1.2	– 0.1	+ 1.3	+ 0.9	Q1	+ 1.5	Jul	3.6	Aug†	2.4
United States	+ 2.5	Q2	+ 3.1	+ 2.4	+ 3.6	– 1.0	Aug	+ 6.3	Jul	6.1	Aug	5.8
Euro area	+ 0.2	Q2	– 0.3	+ 0.5	+ 1.7	– 0.3	Jul	+ 0.7	Jun	8.9	Jul	8.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 0.8	Q2	+ 2.4	na	na	+ 1.9	Jul	+ 2.7	Jun	7.7	Aug†	8.1
Greece	+ 4.5	Q2	+ 0.4	na	na	+ 2.1	Jul	na		na		na
Iceland	+ 2.7	Q2	na	na	na	– 0.3	2002	na		3.0	Jul†	2.3
Ireland	+ 0.5	Q1	na	na	na	+10.7	Jul	+ 2.1	Jul	4.5	Aug	4.3
Luxembourg	+ 1.1	2002	na	na	na	– 3.6	Jun	– 1.6	Mar	3.7	Jul	2.8
New Zealand	+ 3.6	Q1	+ 3.3	na	na	+ 4.2	Q1	+ 5.1	Q2	4.7	Q2	5.2
Norway	– 2.0	Q2	– 0.6	na	na	– 2.8	Jul	+ 5.7	Jul	4.7	Q2	4.0
Portugal	– 2.3	Q2	+ 0.5	na	na	– 0.8	Jul	+ 1.0	Jul	6.2	Q2†	4.5

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††May-Jul; claimant count rate 3.1% in Aug. §EU harmonised rate 9.4% in Aug. **Jun-Aug.

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Prices and wages

Sep 25th 2003
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2003	2004	latest		year ago	latest		year ago
Australia	+ 2.7	Q2	+ 2.8	+ 2.7	+ 2.3	+ 0.2	Q2	– 1.1	+ 5.5	Q2	+ 3.7
Austria	+ 1.1	Aug	+ 1.9	+ 1.3	+ 1.1	+ 1.3	Aug	– 0.6	+ 2.1	Jul	+ 2.4
Belgium	+ 1.8	Aug	+ 1.3	+ 1.3	+ 1.1	– 1.5	Aug	+ 0.8	+ 1.7	Q2	+ 2.6
Britain	+ 2.9	Aug	+ 1.4	+ 2.7	+ 2.4	+ 1.6	Aug	+ 0.4	+ 3.4	Jul	+ 3.9
Canada	+ 2.0	Aug	+ 2.6	+ 2.8	+ 1.9	– 1.6	Jul	– 0.2	+ 3.8	Jun	+ 2.9
Denmark	+ 1.7	Aug	+ 2.3	+ 2.2	+ 1.8	– 0.3	Aug	– 0.4	+ 3.8	Q2	+ 3.7
France	+ 1.9	Aug	+ 1.8	+ 1.8	+ 1.3	+ 0.9	Jun	– 1.4	+ 2.7	Q2	+ 3.9
Germany	+ 1.1	Sep	+ 1.1	+ 0.9	+ 0.6	+ 0.8	Aug	– 0.5	+ 2.2	Jul	+ 2.3
Italy	+ 2.8	Aug	+ 2.4	+ 2.5	+ 1.9	+ 1.3	Jul	+ 0.4	+ 2.1	Jul	+ 2.2
Japan	– 0.2	Jul	– 0.8	– 0.4	– 0.3	– 0.6	Aug	– 2.0	+ 2.8	Jul	– 5.1
Netherlands	+ 2.1	Aug	+ 3.3	+ 2.3	+ 1.8	+ 1.9	Jul	– 0.3	+ 2.0	Jul	+ 3.4
Spain	+ 3.0	Aug	+ 3.6	+ 3.0	+ 2.5	+ 1.1	Aug	+ 0.7	+ 4.9	Q1	+ 4.0
Sweden	+ 1.7	Aug	+ 2.0	+ 2.2	+ 1.6	– 1.7	Aug	– 0.3	+ 3.3	Jun	+ 3.1
Switzerland	+ 0.5	Aug	+ 0.5	+ 0.6	+ 0.6	– 0.3	Aug	– 1.4	+ 1.8	2002	+ 2.5
United States	+ 2.2	Aug	+ 1.8	+ 2.2	+ 1.3	+ 3.4	Aug	– 1.5	+ 2.9	Aug	+ 3.0
Euro area	+ 2.1	Aug	+ 2.1	+ 1.8	+ 1.3	+ 1.3	Jul	– 0.3	+ 3.0	Q1	+ 3.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.6	Aug	+ 1.4	na	na	– 0.1	Aug	– 1.8	+ 4.3	Q2	+ 3.9
Greece	+ 3.3	Aug	+ 3.5	na	na	+ 2.9	Jul	+ 0.9	na		na
Iceland	+ 2.2	Sep	+ 3.1	na	na	+ 3.0	Sep	+ 6.2	+ 5.7	Aug	+ 6.0
Ireland	+ 3.2	Aug	+ 4.5	na	na	– 8.2	Jul	– 3.8	+ 7.1	Q1	+ 6.9
Luxembourg	+ 2.0	Aug	+ 1.8	na	na	+ 2.1	Jun	– 1.3	nil	Jun	– 0.6
New Zealand	+ 1.5	Q2	+ 2.8	na	na	– 2.0	Q2	+ 1.5	+ 2.3	Q2	+ 2.1
Norway	+ 2.1	Aug	+ 1.4	na	na	+ 6.1	Aug	– 8.6	+ 5.4	Q2	+ 4.9
Portugal	+ 2.8	Aug	+ 3.7	na	na	nil	Aug	+ 0.2	nil	Jun	+ 0.5

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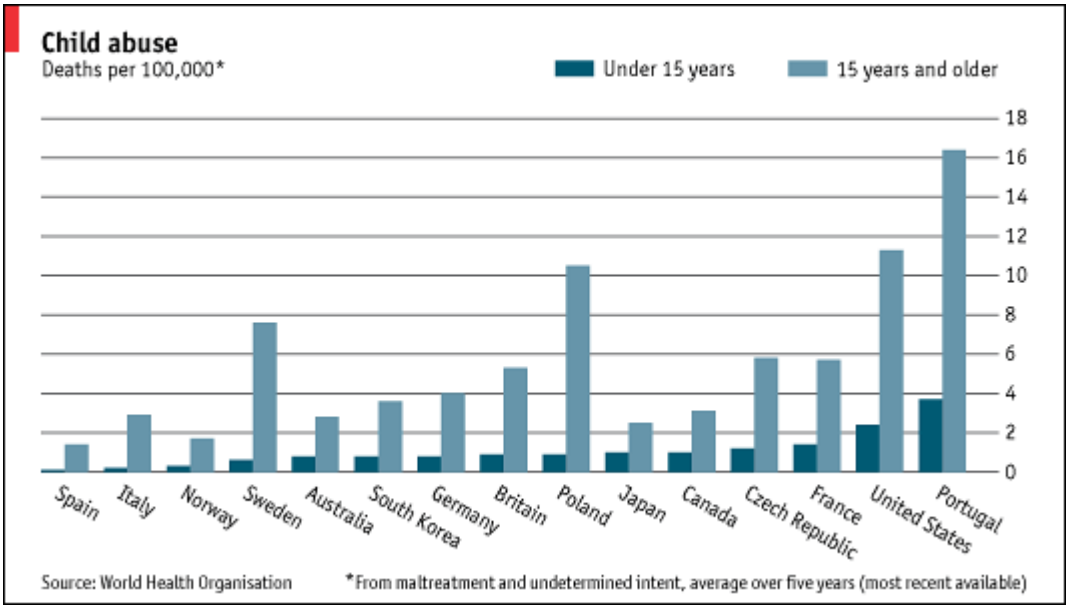
Child abuse

Sep 25th 2003
From The Economist print edition



Almost 3,500 children under the age of 15 die from physical abuse and neglect every year in industrialised countries, according to a report from the UNICEF Innocenti Research Centre. Child deaths from maltreatment are falling in many rich countries, but remain high in Portugal and America. Germany, Norway and Sweden have outlawed the physical punishment of children; Italy and Spain, however, have fewer child deaths.

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Money and interest rates

Sep 25th 2003
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Sep 24th 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 9.5	+13.5	Jul	4.92	4.94	4.94	5.47	5.26	6.19
Britain	+ 7.9	+ 6.6	Aug	3.66	3.91	4.13	4.60	4.41	5.69
Canada	+ 9.3	+ 5.9	Aug	2.59	2.83	2.83	4.64	4.92	6.39
Denmark	+ 7.3	+ 8.9	Aug	2.30	3.40	2.70	4.27	4.50	5.49
Japan	+ 5.5	+ 2.0	Aug	0.01	0.01	0.13	1.28	1.17	1.35
Sweden	+ 3.4	+ 5.1	Jul	2.69	4.15	3.09	4.58	4.83	3.67
Switzerland	+24.8	+ 9.9	Aug	0.24	0.75	-0.14	2.69	2.54	2.85
United States	+ 8.6	+ 8.0	Aug	1.04	1.75	1.61	4.13	3.75	5.89
Euro area†	+11.5	+ 8.5	Jul	2.14	3.29	2.34	4.07	4.25	4.02

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 5.03%, Japan No.253 1.26%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.002%, BOE repo 3.5%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Sep 25th 2003
From The Economist print edition

1995=100

	Sep 16th	Sep 23rd*	% change on one month	% change on one year
Dollar index				
All items	79.8	81.2	+ 1.7	+ 8.6
Food	79.1	80.7	+ 2.1	+ 0.4
Industrials				
All	80.7	81.8	+ 1.1	+21.8
Nfa†	87.1	87.2	+ 1.8	+23.9
Metals	75.3	77.3	+ 0.5	+19.9
Sterling index				
All items	79.2	77.4	- 3.4	+ 2.2
Euro index				
All items	93.8	93.3	- 3.3	- 7.0
Yen index				
All items	98.9	96.3	- 3.5	- 1.9
Gold				
$ per oz	372.50	385.25	+ 6.3	+17.9
West Texas Intermediate				
$ per barrel	27.58	27.12	-15.0	-12.1

* Provisional. † Non-food agriculturals.

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Stockmarkets

Sep 25th 2003
From The Economist print edition

Market indices

	Sep 24th	2003 high	2003 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	3,214.3	3,237.5	2,673.3	- 0.2	- 6.6	+ 8.0	+29.9
Austria (ATX)	1,348.1	1,382.4	1,120.2	- 1.0	-22.4	+17.2	+28.2
Belgium (Bel 20)	2,090.1	2,122.8	1,426.6	- 1.5	-43.2	+ 3.2	+12.8
Britain (FTSE 100)	4,236.4	4,314.7	3,287.0	- 1.3	-38.9	+ 7.5	+10.6
Canada (Toronto Composite)	7,602.3	7,636.0	6,228.6	- 0.1	-33.2	+14.9	+34.0
Denmark (KBX)	211.5	217.5	145.0	- 1.1	-29.9	+27.2	+39.1
France (SBF 250)	2,227.3	2,318.0	1,630.1	- 3.4	-49.3	+ 8.5	+18.6
(CAC 40)	3,263.8	3,422.8	2,403.0	- 3.8	-52.9	+ 6.5	+16.5
Germany (DAX)	3,307.3	3,668.7	2,203.0	- 7.1	-59.0	+14.3	+25.0
Italy (BCI)	1,195.9	1,218.8	959.4	- 1.0	-45.2	+ 9.5	+19.7
Japan (Nikkei 225)	10,502.3	11,033.3	7,607.9	- 4.4	-73.0	+22.4	+29.8
(Topix)	1,043.7	1,075.7	770.6	- 2.7	-63.8	+23.8	+31.3
Netherlands (AEX)	322.2	342.2	218.4	- 4.5	-54.1	- 0.2	+ 9.2
Spain (Madrid SE)	731.9	768.6	576.8	- 3.3	-36.1	+15.4	+26.2
Sweden (Affarsvarlden Gen)	173.3	180.4	127.8	- 3.3	-56.7	+19.3	+34.1
Switzerland (Swiss Market)	5,230.7	5,422.6	3,675.4	- 3.1	-37.8	+13.0	+15.3
United States (DJIA)	9,425.5	9,659.1	7,524.1	- 1.3	-19.6	+13.0	+13.0
(S&P 500)	1,009.4	1,039.6	800.7	- 1.6	-33.9	+14.7	+14.7
(NASDAQ Comp)	1,843.7	1,909.6	1,271.5	- 2.1	-63.5	+38.1	+38.1
Europe (FTSE Eurotop 300)*	895.0	926.5	682.7	- 2.4	-47.5	+ 4.4	+14.2
Euro area (FTSE Ebloc 100)*	754.0	800.8	565.7	- 4.1	-51.4	+ 5.0	+14.7
World (MSCI)†	925.7	944.1	710.8	- 0.8	-36.1	na	+16.8
World bond market (Citigroup)‡	567.5	583.9	518.6	+ 2.8	- 2.8	na	+ 8.0

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Sep 25th 2003
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		Current account The Economist poll % of GDP, forecast 2003	Current account The Economist poll % of GDP, forecast 2004	Exchange rate trade-weighted† 1990=100 Sep 24th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Sep 24th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2003‡
Australia	− 11.8	Jul	− 24.4	Q2	− 5.1	− 4.6	83.1	73.2	1.48	1.84	2.45	1.69	1.32	0.2
Austria	+ 0.1	Jun	+ 1.0	Jul	+ 0.2	+ 0.1	103.1§	100.8	0.87	1.02	1.44	–	0.78	-1.3
Belgium	+ 19.6	Jul	+ 10.7	Mar	+ 4.7	+ 4.7	103.3§	100.0	0.87	1.02	1.44	–	0.78	nil
Britain	− 73.3	Jul	− 5.8	Q1	− 1.1	− 1.3	100.2	107.1	0.60	0.64	–	0.69	0.54	-1.9
Canada	+ 39.1	Jul	+ 14.7	Q2	+ 1.7	+ 1.6	85.9	75.2	1.36	1.58	2.25	1.55	1.21	1.1
Denmark	+ 9.5	Jul	+ 6.0	Jul	+ 2.6	+ 2.4	105.7	102.9	6.48	7.59	10.7	7.43	5.79	1.6
France	+ 5.7	Jul	+ 22.0	Jul	+ 1.4	+ 1.3	106.8§	102.9	0.87	1.02	1.44	–	0.78	-3.6
Germany	+135.1	Jul	+ 53.6	Jul	+ 2.0	+ 1.8	104.5§	99.8	0.87	1.02	1.44	–	0.78	-3.7
Italy	+ 2.1	Jun	− 17.4	Jul	− 0.5	− 0.4	76.1§	73.3	0.87	1.02	1.44	–	0.78	-2.4
Japan	+ 95.1	Jul	+115.9	Jul	+ 2.6	+ 2.8	135.5	132.0	112	123	185	128	–	-7.7
Netherlands	+ 30.3	Jul	+ 2.9	Q1	+ 2.2	+ 2.4	102.8§	99.0	0.87	1.02	1.44	–	0.78	-1.6
Spain	− 45.5	May	− 19.6	May	− 2.4	− 2.3	77.3§	75.0	0.87	1.02	1.44	–	0.78	-0.4
Sweden	+ 16.3	Jul	+ 11.1	Q2	+ 3.6	+ 3.4	82.7	77.4	7.75	9.33	12.8	8.89	6.93	0.7
Switzerland	+ 5.7	Aug	+ 32.7	Q1	+10.7	+10.6	110.8	114.4	1.35	1.50	2.24	1.55	1.21	na
United States	−535.6	Jul	−528.7	Q2	− 5.2	− 5.5	100.9	114.8	–	–	1.66	1.15	0.89	-4.6
Euro area	+ 83.0	Jul	+ 39.0	Jul	+ 0.6	+ 0.5	89.1	81.6	0.87	1.02	1.44	–	0.78	-2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.8	Jul	+ 10.2	Jul	na	na	82.2§	78.9	0.89	1.02	1.47	–	0.80	3.1
Greece	− 24.3	Jul	− 11.6	Jul	na	na	59.7§	58.0	0.89	1.02	1.47	–	0.80	-1.0
Iceland	nil	Jul	− 0.2	Q2	na	na	98.1**	89.0	77.2	87.4	128	88.6	69.0	nil
Ireland	+ 37.4	Jun	− 2.1	Q1	na	na	95.2§	89.3	0.89	1.02	1.47	–	0.80	-0.8
Luxembourg	− 3.3	Jun	+ 1.8	Q1	na	na	103.3§	100.0	0.89	1.02	1.47	–	0.80	0.2
New Zealand	− 1.5	Aug	− 2.9	Q2	na	na	98.4	86.4	1.71	2.13	2.83	1.96	1.53	0.8
Norway	+ 27.3	Aug	+ 26.5	Jun	na	na	99.0	106.8	7.29	7.48	12.1	8.36	6.52	11.3
Portugal	− 12.9	Jun	− 8.5	May	na	na	92.9**	90.0	0.89	1.02	1.47	–	0.80	-3.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, June average. ‡OECD forecast. **IMF, April average.

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Foreign-exchange reserves

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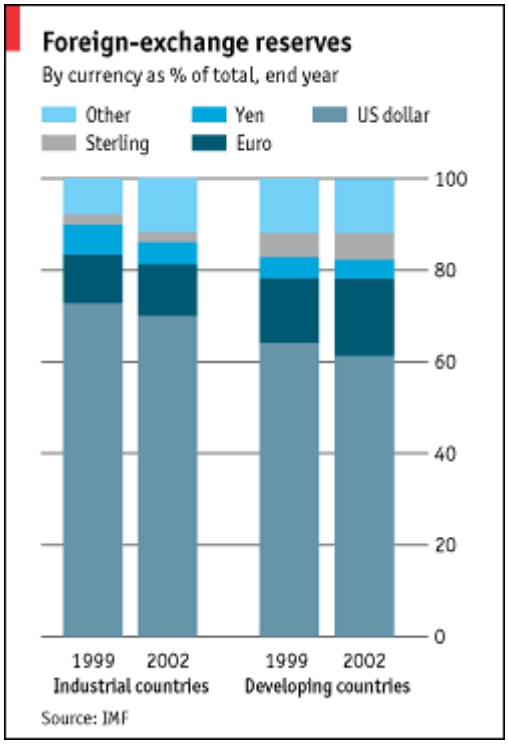

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Overview

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Argentina's GDP grew by a higher-than-expected 7.6% in the year to the second quarter. Industrial production grew by 11.7% in the year to August.

Industrial output in **Taiwan** rose by 5.3% in the year to August, its third straight month of annual growth after the SARS epidemic.

The **Czech Republic's** GDP grew by 2.1% in the year to the second quarter.

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Consumer prices

Sep 25th 2003
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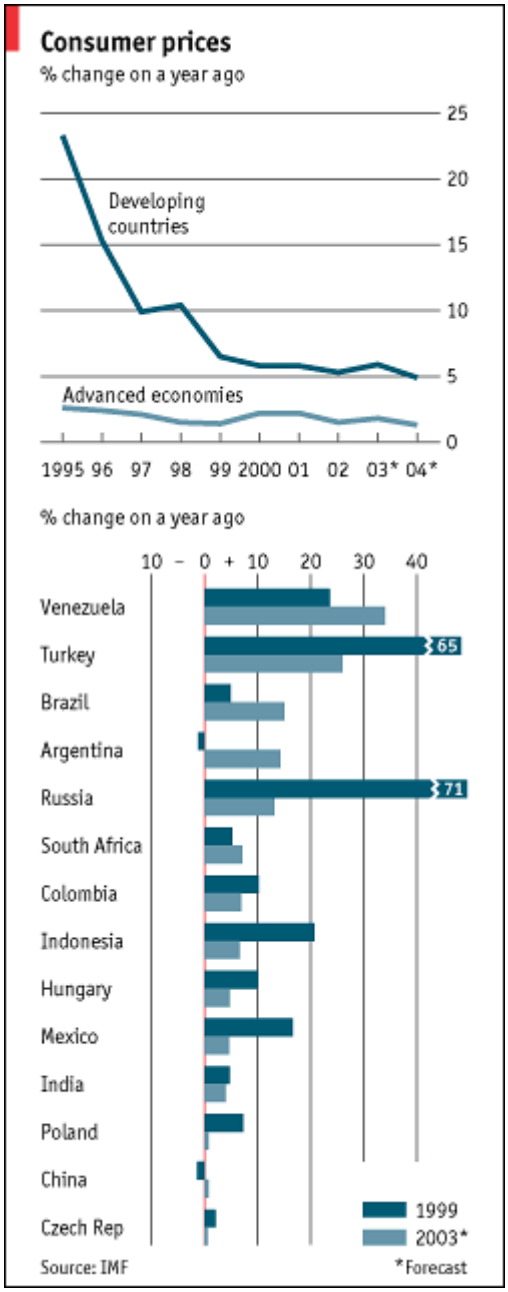
Emerging economies have kept consumer-price inflation stable since 2000, after having reduced it sharply during the late 1990s. Consumer prices rose by an average of 5.3% in 2002 compared with 10.4% in 1998. According to the IMF's latest *World Economic Outlook*, developing countries will likely see inflation rise a bit this year, before falling again in 2004. Among rich countries, only the euro area will see inflation continue to fall, says the report.



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Economy

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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 6.7	Q2	+17.1	Aug	+ 0.9	Aug	+21.4	Aug	+35.4	2002	356.5	Jul
Hong Kong	– 0.5	Q2	–12.5	Q2	– 3.8	Aug	– 6.9	Jul	+18.4	Q1	111.8	Aug
India	+ 4.9	Q1	+ 5.6	Jul	+ 4.2	Jul	–12.3	Jul	+ 4.7	Q1	82.6	Aug
Indonesia	+ 3.8	Q2	+18.3	Mar	+ 6.4	Aug	+25.8	Jul	+ 6.7	Q1	32.3	Jul
Malaysia	+ 4.4	Q2	+ 4.6	Jul	+ 1.0	Aug	+17.0	Jul	+ 8.5	Q1	34.0	Jul
Philippines	+ 3.2	Q2	– 1.2	Jun	+ 3.0	Aug	– 1.1	Jul	+ 3.0	Jun	12.8	Aug
Singapore	– 4.2	Q2	– 6.3	Jul	+ 0.5	Aug	+14.0	Aug	+23.8	Q2	87.8	Aug
South Korea	+ 1.9	Q2	+ 0.7	Jul	+ 3.0	Aug	+ 9.9	Aug	+ 4.1	Jul	136.1	Aug
Taiwan	– 0.4	Q2	+ 5.3	Aug	– 0.6	Aug	+17.3	Aug	+26.9	Q2	185.7	Aug
Thailand	+ 5.8	Q2	+10.3	Jul	+ 2.2	Aug	+ 4.8	Jul	+ 8.9	Jul	36.5	Jul
Argentina	+ 7.6	Q2	+11.7	Aug	+ 4.9	Aug	+17.2	Jul	+10.1	Q1	13.6	Aug
Brazil	– 1.3	Q2	– 2.5	Jul	+15.1	Aug	+22.9	Aug	+ 2.6	Jul	47.3	Jul
Chile	+ 2.7	Q2	– 2.9	Jul	+ 2.9	Aug	+ 2.7	Aug	– 0.8	Q2	15.4	Jul
Colombia	+ 2.0	Q2	+ 1.0	Jun	+ 7.3	Aug	– 0.3	Jun	– 2.1	Q1	10.4	Aug
Mexico	+ 0.2	Q2	– 1.9	Jul	+ 4.0	Aug	– 6.4	Aug	–11.5	Q2	51.5	Aug
Peru	+ 3.3	Jul	+ 1.0	Jul	+ 1.9	Aug	+ 0.4	Jul	– 1.2	Q2	9.0	Aug
Venezuela	– 9.4	Q2	–11.4	Jun	+30.4	Aug	+14.6	Q2	+ 9.3	Q2	11.9	May
Egypt	+ 3.1	2002†	+ 4.2	2002†	+ 4.0	Jun	– 7.1	Mar	+ 1.0	Q1	13.6	May
Israel	– 0.3	Q2	+ 0.4	Jul	– 1.1	Aug	– 6.3	Aug	nil	Q2	24.0	Aug
South Africa	+ 1.8	Q2	– 2.0	Jul	+ 5.1	Aug	+ 3.4	Jul	– 0.9	Q2	6.5	Jul
Turkey	+ 3.9	Q2	+11.9	Jul	+24.9	Aug	–18.7	Jul	– 4.1	Jun	28.7	Jul
Czech Republic	+ 2.1	Q2	+ 4.8	Jul	– 0.1	Aug	– 2.4	Aug	– 5.0	Q2	24.4	Aug
Hungary	+ 2.4	Q2	+ 6.1	Jul	+ 4.7	Aug	– 3.5	Jul	– 4.3	Jul	11.6	Aug
Poland	+ 3.8	Q2	+ 5.8	Aug	+ 0.7	Aug	–10.5	Jul	– 5.4	Jul	30.5	Aug
Russia	+ 7.2	Q2	+ 5.5	Aug	+13.3	Aug	+54.9	Aug	+36.4	Q2	59.0	Aug
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.6	2002†	+15.8	Nov	+ 1.8	Aug	– 1.1	Aug	+ 0.6	Q2†	9.8	Jul
Saudi Arabia	+ 0.7	2002§	na		– 1.0	May	+38.6	2002§	+11.7	2002	21.3	Jun

*Excluding gold, except Singapore; IMF definition. †Year ending June. §Economist Intelligence Unit estimate.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

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Financial markets

Sep 25th 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Sep 24th		Dec 31st 2002	
	Sep 24th	year ago	Sep 24th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.7	na	1,461.0	+0.3	+ 2.9	+ 2.9
Hong Kong	7.76	7.80	12.9	0.88	11,295.9	+1.4	+ 21.2	+ 21.8
India	45.8	48.4	75.9	4.57	4,356.4	+2.9	+ 29.0	+ 35.0
Indonesia	8,438	9,000	13,978	9.01	605.6	+3.4	+ 42.5	+ 51.2
Malaysia	3.80	3.80	6.29	3.10	745.0	-0.3	+ 15.3	+ 15.3
Philippines	55.1	52.4	91.3	7.56	1,318.6	-0.2	+ 29.5	+ 25.4
Singapore	1.74	1.78	2.88	0.81	1,634.0	+2.0	+ 21.8	+ 21.7
South Korea	1,150	1,230	1,906	3.80	724.7	-5.5	+ 15.5	+ 19.1
Taiwan	33.8	34.9	56.0	1.15	5,722.4	-0.4	+ 28.5	+ 32.2
Thailand	40.1	43.4	66.3	1.28	575.6	+3.0	+ 61.5	+ 73.7
Argentina	2.89	3.66	4.78	5.19	811.7	+1.5	+ 54.6	+ 80.2
Brazil	2.92	3.75	4.84	19.85	16,077.6	-2.5	+ 42.7	+ 72.9
Chile	656	745	1,087	2.76	6,848.5	+0.8	+ 36.4	+ 49.7
Colombia	2,874	2,796	4,760	7.78	2,128.9	-1.6	+ 32.3	+ 32.0
Mexico	10.80	10.27	17.9	4.47	7,788.1	+0.5	+ 27.1	+ 23.1
Peru	3.48	3.64	5.77	2.80	1,997.1	+2.7	+ 43.5	+ 44.8
Venezuela	1,598	1,463	2,647	17.68	16,951.7	-4.9	+111.5	+ 83.5
Egypt	6.15	4.63	10.18	7.98	9,787.6	+1.7	+ 82.2	+ 37.3
Israel	4.45	4.88	7.37	3.55	436.4	+4.0	+ 31.3	+ 40.2
South Africa	7.1	10.6	11.8	9.50	9,156.4	-2.8	- 1.3	+ 18.8
Turkey	1,351,500	1,650,000	2,238,760	28.00	13,798.3	+6.5	+ 33.1	+ 63.4
Czech Republic	27.8	31.1	46.0	2.06	621.8	-4.0	+ 35.0	+ 46.3
Hungary	221	249	365	9.41	9,137.4	-1.9	+ 17.2	+ 19.4
Poland	3.92	4.15	6.49	5.20	19,824.8	-2.0	+ 38.0	+ 35.0
Russia	30.4	31.7	50.4	16.00	560.7‡	+1.8	+ 48.6	+ 56.2
EMF (MSCI)*	1.00	1.00	1.66	na	383.3	-0.4	na	+ 31.2
EMBI+†	1.00	1.00	1.66	na	279.5	+0.2	na	+ 22.1

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

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